

CIVIL DISTRICT COURT  
PARISH OF ORLEANS  
STATE OF LOUISIANA

GLORIA SCOTT AND \*  
DEANIA JACKSON \*  
\* NO. 96-8461  
VERSUS \* DIVISION "I"  
\* SECTION 14  
THE AMERICAN TOBACCO \*  
COMPANY, INC., ET AL. \*  
\*  
\* \* \* \* \*

Transcript of proceedings before The  
Honorable Richard J. Ganucheau, Judge Pro Tempore,  
Civil District Court, Parish of Orleans, State of  
Louisiana, 421 Loyola Avenue, New Orleans, Louisiana  
70112, commencing on June 18, 2001.

\* \* \* \* \*  
Friday Morning Session  
May 2, 2003  
9:39 a.m.  
\* \* \* \* \*

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19587

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19588

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19590

1 I N D E X  
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WITNESS: PAGE  
3  
4 David T. Scheffman, Ph.D.  
Videotape of Deposition.....19591

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1 P R O C E E D I N G S  
2 THE MINUTE CLERK:  
3 All rise for the jury.  
4 (Whereupon the jury joins the  
5 proceedings at this time.)  
6 THE MINUTE CLERK:  
7 All rise, please.  
8 Oyez, oyez, oyez, Civil District Court  
9 for the Parish of Orleans, State of  
10 Louisiana, is now in session. The Honorable  
11 Richard Ganucheau presiding. Please be  
12 seated.  
13 THE COURT:  
14 Good morning.  
15 THE JURY:  
16 Good morning.  
17 THE COURT:  
18 Are we ready to continue with the

19 deposition of Dr. Scheffman?  
20 MR. COPLEY:  
21 Yes, we are, Your Honor.  
22 THE COURT:  
23 All right. Proceed.  
24 (Whereupon the above-referenced  
25 videotape is played back at this time as  
26 follows:)  
27 QUESTION: Dr. Scheffman, could you  
28 please tell the jury what your opinions are  
29 in this case?  
30 ANSWER: Well, I'm testifying based on  
31 my expertise in economics and marketing. And  
32 the issues I am particularly dealing with is  
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19592

1 competition --  
2 (Whereupon the playback of the above-  
3 referenced-videotape is paused at this time.)  
4 THE COURT:  
5 Can you folks see that well enough that  
6 we can leave the lights on?  
7 THE JURY:  
8 Yes.  
9 THE COURT:  
10 All right. Let's continue with it then  
11 with the lights on.  
12 Thank you.  
13 (Whereupon the playback of the above-  
14 referenced videotape is resumed at this time  
15 as follows:)  
16 ANSWER: -- and the allegations that the  
17 companies conspired to reduce competition.  
18 I've studied the industry and the  
19 history of competition in the industry over  
20 the last fifty years. And my conclusion is  
21 that the industry has been very competitive  
22 for at least fifty years. And, particularly,  
23 that competition has been on innovation, on  
24 the introduction -- on the development and  
25 introduction of potentially safer cigarette  
26 products.  
27 Second, my second opinion having to do  
28 with marketing is that with respect to the  
29 companies advertising, the FTC has exerted  
30 close oversight and regulatory responsibility  
31 over the cigarette companies advertising for  
32 over fifty years. And that has to be -- that  
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19593

1 has to be taken into account in understanding  
2 how the companies have chosen to advertise  
3 the products that they've introduced in the  
4 marketplace.  
5 QUESTION: Are you aware of the opinions  
6 that the plaintiffs' expert economist,  
7 Professor Jaffe, has in this case?  
8 ANSWER: Yes.  
9 QUESTION: And how do you know about Dr.  
10 Jaffe's opinions in this case?  
11 ANSWER: Dr. Jaffe, as I did, produced a

12 report summarizing his opinions and the bases  
13 of those opinions. He also had a question  
14 and answer sort of session like this with  
15 lawyers, and I read a transcript of that.  
16 I'm also familiar with Dr. Jaffe's testimony  
17 in some other similar cases in which he's  
18 testified at trial.

19 QUESTION: Okay. Do you agree with Dr.  
20 Jaffe's opinion that the cigarette industry  
21 has not competed on health issues over the  
22 last fifty years?

23 ANSWER: No, my conclusion is quite the  
24 opposite. The, fundamentally, competition in  
25 this industry over the last fifty years has  
26 been fundamentally about health issues, that  
27 is, has been about trying to develop and  
28 introduce products that were potentially less  
29 risky.

30 QUESTION: Okay. I'll ask you about  
31 those opinions in detail in a few minutes.

32 But, first, let's briefly go through your  
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19594

1 methodology so that the jury understands what  
2 it is you did here.

3 Could you describe for the jury what you  
4 were asked to do in this case?

5 ANSWER: Well, again, as an economist  
6 and marketing expert, the expertise I can  
7 bring to bear is study how competition --  
8 the nature of competition and how much  
9 competition there is, there has been in the  
10 industry.

11 So one of the things I was asked to do  
12 was to study exactly that, look -- study the  
13 competition in the industry. This case  
14 involves allegations that the companies have  
15 been involved in various conspiracies that  
16 are going on for almost fifty years that have  
17 resulted in a lessening of competition.

18 So my job as an economist was to study  
19 what has been the nature of competition and  
20 form conclusion -- a conclusion as to whether  
21 there has been a lessening of competition or  
22 whether, in fact, the industry has been very  
23 competitive, which is what I've done.

24 I've also been asked to study the  
25 advertising of the industry, the general  
26 advertising. And as an economist and  
27 marketing expert, the effects of Federal  
28 Trade Commission advertising regulation on  
29 industry advertising.

30 QUESTION: Was this economic analysis  
31 that you did in this case similar to the  
32 kinds of analysis that you conducted while

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19595

1 you were employed at the Federal Trade  
2 Commission?

3 ANSWER: It's exactly the same sort of  
4 analysis that is used. In studying an

5 industry to determine whether there's been  
6 a less -- anticompetitive lessening of  
7 competition, you study a history of  
8 competition in the industry in order to  
9 understand what really drives competition,  
10 what has been the nature of competition, how  
11 much competition is there. That's exactly  
12 the sort of analysis that you do at the  
13 Federal Trade Commission.

14 QUESTION: And have you prepared some  
15 charts explaining to the jury how an  
16 economist goes about evaluating allegations  
17 of a conspiracy?

18 ANSWER: Yes, I have.

19 QUESTION: And would these charts help  
20 you in describing what you did in this case  
21 for the jury?

22 ANSWER: Yes, I think so.

23 QUESTION: Okay. We've marked as  
24 "Exhibit 2" some of these charts, Doctor.

25 Could you explain for the jury how an  
26 economist does evaluate allegations of a  
27 conspiracy?

28 (Whereupon the document as described  
29 above was marked as "Scheffman Exhibit  
30 Number 2.")

31 ANSWER: Okay. Well, again, remember,  
32 economists mainly deal with numbers and

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19596

1 facts. So what we -- in analyzing  
2 competition in an industry, what we do is  
3 look at a history and we collect all sorts of  
4 facts and numbers and information. So we  
5 look at evidence.

6 We look at, say, for the domestic -- If  
7 it's an allegation of potential lessening of  
8 competition in the U.S. market, we look at  
9 the U.S. domestic or U.S. marketplace  
10 conditions. And we look at how that's  
11 changed over time because competition is  
12 impacted by lots of things. It's impacted by  
13 government regulations, it's impacted by  
14 imports.

15 So you think about the automobile  
16 industry is very different now than it was  
17 twenty-five years ago now that, say, the  
18 Japanese manufacturers have a major share of  
19 the U.S. auto industry. They didn't have  
20 much share in 1975. So various factors over  
21 time change the nature of competition in the  
22 industry.

23 We look at the international marketplace  
24 conditions and changes because, as we all  
25 know, for the last twenty years, what happens  
26 in other markets has very important  
27 implications for what happens in the U.S.  
28 Strong companies and other companies who may  
29 not be competing here today, maybe like  
30 Toyota, and they may be here tomorrow.

31 We look at the regulatory environment  
32 changes. And the regulatory environment,

19597

1 again in the auto industry, what we had in  
2 the 1970s and since, we've had various  
3 regulations imposed, say, on the auto  
4 industry that result in the companies having  
5 to produce smaller cars because they're  
6 required to produce minimum mileage --  
7 maximum mileage standards.

8 So changes in regulatory environment, in  
9 this case in particular, looking at FTC  
10 regulation of advertising is a key issue.

11 The information environment, when we're  
12 looking about allegations having to do with  
13 fraud and deception, as consumers might be  
14 deceived or misled, we look at the  
15 information environment, what sort of  
16 information do people have about different  
17 issues.

18 And then, of course, in understanding  
19 competition, what do the companies actually  
20 do? Competition is different in different  
21 industries. If we look at the soft drink  
22 industry, say, the competition we see is  
23 mainly about price. You see all the sales  
24 that go on everywhere you buy soft drinks.  
25 You can buy a twelve-pack one day for a  
26 dollar twenty-five, and another day it might  
27 be three dollars or something.

28 And on advertising. We see in the beer  
29 industry the advertising is mostly about,  
30 mostly about advertising and not so much  
31 price competition. In the commercial  
32 aircraft industry, the companies that produce

19598

1 aircraft, the competition is mostly about  
2 developing new planes.

3 So what form competition takes is  
4 different in different industries and it  
5 varies by company.

6 QUESTION: What does this next board  
7 show?

8 ANSWER: Okay. What this summarizes --  
9 Well, what sort of things do we look at,  
10 okay, in studying competition and the history  
11 of competition in the industry? Well, we  
12 look at all sorts of documents, reports,  
13 testimony. If it's a legal case, you  
14 typically look at lots of company documents,  
15 what is -- what is the company -- what seems  
16 to be going on in the company? Is it  
17 according to the documents? Looking at  
18 reports, looking at testimony again in legal  
19 cases, looking at testimony of government  
20 executives, looking at company executives and  
21 others.

22 Looking at public source material, in  
23 this case we're -- in this case involves  
24 allegations that the defendants have  
25 conspired going back to the 1950s. So what



26 we did is looked back at going back to the  
27 early 1950s, looked at all sorts of public  
28 source material.  
29 For example, there's been, going back to  
30 the 1950s, there's regularly been major  
31 federal government congressional hearings  
32 regularly about the, about the -- involving  
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19599

1 the cigarette industry. Surgeon General's  
2 reports we've had since 1964 periodically,  
3 a number of them each decade. Surgeon  
4 General's reports specifically about smoking  
5 and health.

6 Business publications, newspapers,  
7 magazines, et cetera, those sources all are  
8 people covering the industry, say, the  
9 cigarette industry, covering public health  
10 issues that are related to smoking and  
11 health.

12 So there's all sorts of historical  
13 information in those sorts of sources which  
14 shed light on what was going on in the  
15 industry.

16 And then important in the cigarette  
17 industry and smoking and health issues,  
18 international public source material.  
19 Because in this case, of course, central in  
20 this case is that smoking -- cigarettes are a  
21 dangerous product, that people die because  
22 they smoke. And that's not a problem just in  
23 the U.S.; it's a problem all across the world  
24 and has been for a long time.

25 So for a long time, governments of other  
26 countries have been concerned with that, the  
27 public health authorities, the public health  
28 authorities in other countries have been  
29 involved, very involved in smoking and health  
30 issues. There's international organizations  
31 like the U.N. and various -- the World Health  
32 Organization have been involved in smoking

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19600

1 and health. And, also, there are big  
2 cigarette companies, like Japan Tobacco and  
3 other companies which aren't U.S. cigarette  
4 companies, that sell cigarettes in other  
5 parts of the world.

6 QUESTION: And what does your last board  
7 here show?

8 ANSWER: This is, again, my role as an  
9 economist in analyzing conspiracy is to look  
10 at what was the nature of competition? How  
11 much competition was there? Does the  
12 evidence, does the economic evidence support  
13 the conclusion that there was a conspiracy  
14 that resulted in a significant lessening of  
15 competition? What does the economic facts  
16 and data show?

17 That's my -- That's what I can bring to  
18 this proceeding. So we look at all the facts

19 and data on those two previous boards. We're  
20 talking a mountain of evidence, thousands and  
21 thousands of pages of documents and data of  
22 various kinds. And then apply various  
23 economic analyses. One of which is if  
24 someone alleges there's a particular  
25 conspiracy occurred, is that conspiracy  
26 plausible?

27 For example, one of the allegations in  
28 this case of Dr. Jaffe is that there was a  
29 conspiracy that led to the result of not  
30 producing a safer product. My conclusion, as  
31 I'll talk about in a little while, is that  
32 that doesn't make any sense. That if the

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19601

1 companies would have been able to produce a  
2 safer product, they would have sold a lot  
3 more cigarettes and they would be a lot  
4 better off than they are today. So we look  
5 as a matter of economics, is such a  
6 conspiracy plausible?

7 Second, we can look at where there are  
8 allegations that in a given situation, as in  
9 this case, it's argued that the companies did  
10 specific things because they were conspiring  
11 or they didn't do certain things because they  
12 were conspiring, we can look at the evidence  
13 and look at is it true? Did they actually do  
14 those things they're accused of doing or did  
15 they not do those things just as a matter of  
16 evidence in looking at their activities as to  
17 what their actions were.

18 Finally, you can look at the effects,  
19 that is, are the effects of the conspiracy,  
20 are the effects that you see in the  
21 marketplace, are those consistent with a  
22 conspiracy that fundamentally lessened  
23 competition or are the results in the  
24 marketplace you see the result of  
25 competition?

26 So that's the issue, if there was a  
27 conspiracy, did it have a significant effect  
28 in the marketplace?

29 For example, you can have a group of  
30 bottlers, say, soft drink bottlers, who try  
31 to get together and raise the price. And say  
32 that's clear, they confess "That's what we

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19602

1 did." But it might turn out, you can show  
2 from the data, that, in fact, they weren't  
3 able to do it somehow. They didn't -- They  
4 weren't able to get their act together and so  
5 they actually weren't able to raise the  
6 price, even though that's what they intended  
7 to do. So you can look at that issue.  
8 That's something an economist can look at.

9 QUESTION: Okay. Are these three boards  
10 you've just shown us how you went about  
11 reaching the opinions you have in this case?

12                   ANSWER: Yes.  
13                   Getting together a whole bunch of facts  
14                   and data, then applying economic analysis and  
15                   marketing analysis to those facts and data to  
16                   reach conclusions about the nature of  
17                   competition and the nature of advertising in  
18                   the cigarette industry.

19                   QUESTION: Is the method you've just  
20                   described accepted by economists in analyzing  
21                   alleged conspiracies?

22                   ANSWER: Yes. It's a standard  
23                   methodology.

24                   QUESTION: Okay. Could you briefly  
25                   explain to the jury the ways in which  
26                   companies compete?

27                   ANSWER: Well, as I've said before, the  
28                   nature -- Companies compete on the products  
29                   they produce, okay? I've produced a summary  
30                   board here that will summarize the ways  
31                   companies compete. What do they -- What do  
32                   companies compete about? Well, they compete

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19603

1                   about what they actually produce. What are  
2                   their products?

3                   Soft drinks, do you produce soft drinks  
4                   in 12-ounce bottles or 20-ounce bottles or  
5                   12-ounce cans? Do you produce it as a  
6                   fountain? What other products do you  
7                   produce? A cola or a lemon lime? Do you  
8                   produce a NutraSweet™ added product? Do you  
9                   produce a sugar product? So what products do  
10                   you actually produce? That's, obviously, one  
11                   important thing about which companies  
12                   compete.

13                   Second, of course, they compete in their  
14                   pricing, they compete in how they price their  
15                   product. And they compete with one another  
16                   about the pricing.

17                   Third, they compete in their advertising  
18                   and promotion.

19                   Okay. Fourth, they compete in how they  
20                   distribute their products. Some products are  
21                   sold in supermarkets, some products are sold  
22                   in convenience stores, some products are sold  
23                   in places like J. C. Penney's and Dillard's  
24                   and things like that and you don't find them  
25                   in the supermarket. So they compete in how  
26                   they distribute their product.

27                   They compete in research and  
28                   development, in trying to become more  
29                   efficient and trying to develop new products.  
30                   So trying to become more efficient, new  
31                   manufacturing techniques, new ways of  
32                   delivering services. Or in developing new

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19604

1                   products and services.

2                   Finally, companies compete in the range  
3                   of businesses that they compete in. Big  
4                   companies are usually in a variety of

5 different industries. They choose to compete  
6 in different -- in all sorts of different  
7 industries, a large company. So that's  
8 another range -- that's another aspect of  
9 competition.

10 QUESTION: Okay. When economists  
11 analyze competition in an industry, do they  
12 use all of the bullet points you've got here  
13 on your chart?

14 ANSWER: Those are all the areas, the  
15 main areas that you'd look at as to what they  
16 might be competing about. As I said before,  
17 in different industries in different  
18 companies, the emphasis of these different  
19 things are different.

20 QUESTION: When you analyzed competition  
21 in the cigarette industry, did you use these  
22 tools?

23 ANSWER: Yes.

24 QUESTION: You mentioned collecting  
25 company documents. Did you collect cigarette  
26 company documents in this case and look at  
27 them?

28 ANSWER: Yes.

29 QUESTION: Okay. And how did you go  
30 about collecting those?

31 ANSWER: Well, there are two main  
32 sources -- there are three main sources of

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19605

1 documents.

2 First, for a number of years now, all  
3 the cigarette company documents are available  
4 by computer on a so-called website that you  
5 can just search on your computer, dial in,  
6 and you can search and get documents.

7 Second, there's a large warehouse in  
8 Minneapolis that has a whole bunch of -- that  
9 actually has hard copies of the documents,  
10 and I've searched there. So I searched on  
11 the website, searched in this giant warehouse  
12 in Minneapolis that has all the documents.

13 And then I've also at various times  
14 asked lawyers for the cigarette companies,  
15 "Do you have documents on advertising? What  
16 documents do you have on the development of  
17 new products and research and development?"

18 So those have been three main sources.  
19 And then I've -- am testifying in this case  
20 and I've testified in some other cases. So  
21 in those matters, as in trial, a number of  
22 other documents came forward which I've  
23 reviewed.

24 QUESTION: Have you also looked at the  
25 company documents that plaintiffs' experts  
26 rely upon in reaching their opinions and  
27 attached to their reports, such as Professor  
28 Jaffe?

29 ANSWER: Yes.

30 QUESTION: Okay. Why didn't you just  
31 rely on company documents to answer  
32 everything that was going on?

19606

1 ANSWER: Well, company documents don't  
2 always give you all the facts of what's going  
3 on. For example, if you want to -- you  
4 can't, from any company documents, figure out  
5 what the market share of a company is.

6 Companies don't know what their market  
7 -- They have a guess what their market share  
8 is. But someone on the outside collects all  
9 the data and usually is the authoritative  
10 source on what the market shares of the  
11 companies are.

12 Tar and nicotine ratings of cigarettes,  
13 those are measured by the FTC. You have to  
14 go to public source material for that. Any  
15 documents, there are literally, as in any big  
16 company, there's literally millions of  
17 documents involved here. And I doubt that  
18 anyone has read all the documents that are  
19 available of all the cigarette companies,  
20 there are so many of them. We've looked at  
21 many, many of them.

22 But there's a lot of -- there's a lot of  
23 material and public source material of people  
24 who covered the industry or regulated the  
25 industry or congressional hearings and things  
26 like that, a massive amount of materials, you  
27 can imagine for fifty years, which has all  
28 sorts of facts and data which you won't find  
29 in the company documents.

30 QUESTION: Have you also talked to any  
31 cigarette company employees in the course of  
32 your investigation in this case in reaching

19607

1 your opinions?

2 ANSWER: Yes, I have.

3 QUESTION: Okay. And what were the  
4 nature of those discussions?

5 ANSWER: Well, I visited with employees  
6 of both Philip Morris and RJR a few years  
7 ago. And in order to talk to them about the  
8 development of new products, how they went  
9 about developing new products like Premier  
10 and other things that I'll talk about later.

11 And I also talked about -- to the people  
12 who manufacture cigarettes and have gone  
13 through the cigarette manufacturing plant and  
14 seen how cigarettes are manufactured, talked  
15 to the manufacturing people about the  
16 difficulties in producing these more  
17 innovative products like Premier.

18 QUESTION: Doctor, how far back in time  
19 did you go in analyzing competition and the  
20 regulatory environment of the cigarette  
21 industry?

22 ANSWER: I began -- I began -- Actually,  
23 a little bit going back to the beginning of  
24 the tobacco industry, which goes back a  
25 couple centuries. But most of my efforts

26 began in the 1940s and concentrated on the  
27 1950s going forward.  
28 QUESTION: So the basic focus then of  
29 your analysis has been the last fifty years;  
30 is that right?

31 ANSWER: That's right.

32 QUESTION: Okay. And what have you  
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19608

1 concluded as a result of your analysis?

2 ANSWER: Again, my conclusion is that  
3 this industry has been, in a way, uniquely  
4 competitive in that the focus of competition  
5 in this industry -- and there's been a lot of  
6 competition -- has been on the companies'  
7 attempt to produce products that were  
8 potentially lower risk, lower tar, lower  
9 nicotine, lower other constituents, and also  
10 producing various breakthrough products like  
11 Premier.

12 QUESTION: Is the competition by the  
13 companies in the cigarette industry reflected  
14 in their market share over the years?

15 ANSWER: Yes.

16 QUESTION: Have you prepared a chart on  
17 the market share of the cigarette companies  
18 over the years?

19 ANSWER: Yes, I have.

20 QUESTION: Okay. I'm showing you what  
21 we've marked as "Exhibit 4" to the  
22 deposition.

23 Could you explain to the jury what this  
24 shows?

25 (Whereupon the document as described  
26 above was marked as "Scheffman Exhibit  
27 Number 4.")

28 ANSWER: Now, one of the most important  
29 indicators of competition for a company, like  
30 when I teach M.B.A.s or executives, they're  
31 -- generally, the thing they're most  
32 concerned about is market share and

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19609

1 profitability.

2 Market share is an indicator of how  
3 you're doing in the market. If you have the  
4 biggest market share in the market, then  
5 you're the biggest guy in the market. And  
6 there are big advantages to that.

7 And as an economist when you're studying  
8 competition, one of the most important  
9 indicators of competition is market share.  
10 All right. What I've done in this chart,  
11 this is a historical chart. Notice at the  
12 bottom here (indicating), these are years.  
13 So beginning in 1950 going up to the year  
14 2000, these are the years.

15 On this axis here, I'm measuring --  
16 those are percentages. And those are  
17 percentages of market share. Now, remember,  
18 on market share, we use market share as a

19 percentage. And there's a good reason why we  
20 do that. And that's because percentages add  
21 up to be a hundred percent.

22 So, for example, in the soft drink  
23 industry, Coca-Cola has a share in the  
24 forties, say, maybe about 45 percent and  
25 Pepsi has a share of about 35 percent and  
26 other folks then have a share of about 20  
27 percent. Those all add up to be a hundred  
28 percent.

29 So in market share, if you pick up five  
30 points of market share, it means your  
31 competitors, some of your competitors lost  
32 five points of market share because there's

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19610

1 only a hundred points of market share to go  
2 around. That's why we look at market share.

3 All right. Now, what this chart shows,  
4 going back to 1950, there were six cigarette  
5 companies. And what I've looked at  
6 historically, these different lines show the  
7 shares, the market shares, of the individual  
8 six companies, okay?

9 So we have American Tobacco the yellow,  
10 R. J. Reynolds the green, Liggett & Myers the  
11 red, Philip Morris the orange, Lorillard the  
12 purple, and Brown & Williamson the blue.  
13 Those lines show how the market shares of the  
14 companies have evolved over time.

15 Now, what's really interesting in this  
16 industry, and it's very -- quite unique  
17 compared to other industries is look at -- if  
18 we go back to 1950 and we look at what the  
19 positions of the companies were, look at who  
20 the big company was: American Tobacco.

21 That's a company most of us haven't  
22 heard about because it hasn't existed now for  
23 over ten years. But back in 1950, it was the  
24 largest company in the industry. And if you  
25 look at its share, you see starting in 1950  
26 going onward, American Tobacco eventually  
27 disappeared, okay? It was eventually sold  
28 off and dismembered, sold to other companies.  
29 It had fallen to its share being about five  
30 percent. So the biggest company in 1950 no  
31 longer exists, okay?

32 Another company, look at Liggett.

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19611

1 Liggett & Myers was the third-largest company  
2 in 1950. It had a share of almost 20  
3 percent. Liggett & Myers hardly exists  
4 anymore. It still exists as an independent  
5 company but it has a really tiny share.

6 Whereas, Philip Morris, which is now the  
7 biggest company, that's Marlboro and  
8 everything, they're the biggest cigarette  
9 company in the U.S., they were the fourth  
10 largest out of six in 1950. They had a share  
11 of about 10 percent. Now they're the big dog

12 in the market, they have a share of about 50  
13 percent.  
14 So this sort of a chart is an indication  
15 to economists, boy, this is an industry with  
16 a lot of competition because we know, as Mr.  
17 Murray said, companies compete on market  
18 share. Here's a company that started as the  
19 big company and had no share, Liggett, the  
20 third largest and essentially no share; where  
21 Philip Morris starts as a very small company  
22 and ends up as the biggest.

23 This is one of the most important  
24 indicators of competition in the industry.  
25 This is very unusual, this sort of  
26 competition for this sort of product, for a  
27 consumer product.

28 Think about the consumer products you  
29 think about. Soft drinks. Coca-Cola was the  
30 biggest company in 1950, still the biggest  
31 company. Pepsi was the second-biggest  
32 company, still the second-biggest company.

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19612

1 Look at breakfast cereal. Kellogg's and  
2 General Mills were the biggest companies in  
3 1950. Who's the biggest companies now?  
4 Kellogg's and General Mills. Think about  
5 beer. Anheuser-Busch was a big brewer in  
6 1950 and it's the big brewer today.

7 So you think about most consumer  
8 products, much more stable market shares.  
9 The big companies in 1950 are generally  
10 Procter & Gamble, again, was the big soap  
11 company in 1950; it's still the biggest soap  
12 company in the economy. So in most -- in  
13 consumer products, much, much more stability  
14 in market share in almost all industries.

15 This is a sign of an incredible amount  
16 of competitive forces going on in this  
17 industry to have the largest company go out  
18 of business and one of the smallest companies  
19 grow up to be, by far, the biggest in the  
20 industry. This is a clear indication of a  
21 tremendous amount of competition in this  
22 industry.

23 QUESTION: Have you prepared another  
24 chart that also demonstrates this competition  
25 as reflected in changing market shares?

26 ANSWER: Yes, I have.

27 MR. MURRAY:

28 Jim, why don't we take a break?

29 MR. MUEHLBERGER:

30 That's fine.

31 EXAMINATION BY MR. MUEHLBERGER:

32 QUESTION: Doctor, before we took our

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19613

1 break, we were talking about your board,  
2 "Exhibit 4," the "U.S. Cigarette Industry  
3 Market Shares" for the last fifty years.  
4 Is market share data generally used and



5 relied upon by economists in evaluating  
6 competition?  
7 ANSWER: Yeah, it's among the most  
8 important data that economists rely on.  
9 QUESTION: Okay. And is this a summary  
10 of various commercial and industry  
11 information on market shares as reflected in  
12 the sources that you've indicated there on  
13 the lower left of your board?  
14 ANSWER: Right.  
15 These sources here, there's someone  
16 called Maxwell that actually does a service  
17 that estimates market share among the  
18 companies. Again, this is not -- you can't  
19 get market shares in most industries. You  
20 really can't get market share from company  
21 documents because a company only knows its  
22 own sales. It doesn't know for shoe what its  
23 competitors' sales are. That usually comes  
24 from third-party sources, in this case  
25 Maxwell, which is the definitive source on  
26 market share data in the cigarette industry.  
27 QUESTION: Okay. Move to admit "Exhibit  
28 4."  
29 What is the -- Going to the next board  
30 that we started to talk about, could you  
31 explain for the jury what "Exhibit 5" shows?  
32 ANSWER: Well, that chart with all the  
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19614  
1 colored lines, the past one, is the sort of  
2 thing economists really like showing data in  
3 a complicated way with a lot of lines.  
4 That's not everyone's cup of tea.  
5 So what we've done here instead is  
6 summarized, instead of having a chart with  
7 a bunch of complicated lines, just have the  
8 shares.  
9 Here's the shares of the companies.  
10 Remember, there are six companies in 1954 --  
11 in the 1950s, there's five today. This  
12 column lists what their share of the company  
13 was in 1954, and this is what the share was  
14 at best estimates as of last year.  
15 So here, again, we see American Tobacco,  
16 the biggest company in 1954, doesn't exist  
17 anymore and hasn't existed for over ten  
18 years, okay? And Liggett, which was the  
19 third-largest company in the fifties, now has  
20 a very tiny share.  
21 QUESTION: Okay. And is this also based  
22 on underlying industry sales documents that  
23 you've summarized on this board?  
24 ANSWER: The same source material as the  
25 previous chart with the lines.  
26 QUESTION: Okay. Move to admit.  
27 Have you prepared another board that  
28 demonstrates what happened -- what the top  
29 brands were of cigarettes in 1950 and where  
30 they are today?  
31 ANSWER: Yes, I have.  
32 QUESTION: Okay. And could you explain

19615

1 to the jury what this board shows and how  
2 it's relevant to your opinions in this case?

3 ANSWER: Okay. Well, remember, the  
4 cigarette companies are consumer product  
5 companies. So if we think about them like  
6 any other consumer product company, we think  
7 about what brands do they sell. So, for  
8 example, Coca-Cola sells Coca-Cola and  
9 Pepsi-Cola sells Pepsi-Cola. Anheuser-Busch  
10 sells Budweiser. Procter & Gamble sells  
11 Ivory soap and Tide.

12 So if we look at the brand products that  
13 the cigarette companies sell, this chart  
14 lists the companies and their brands. And  
15 this lists who the major -- what the major  
16 brands were in 1950.

17 So the biggest brand in 1950 was a  
18 Reynolds brand, it was Camel, it still exists  
19 today, it had the biggest single share, 27  
20 percent, okay?

21 Now, what's really interesting about  
22 this chart is if you look in 1950, most of  
23 the brands that were the big brands in 1950  
24 are very small and some no longer exist.

25 Like look at Philip Morris. Its biggest  
26 brand in 1950 and almost all of its sales  
27 were accounted for by a brand called  
28 Commander, which for a long time doesn't --  
29 it doesn't even exist anymore. Camel still  
30 exists but it's one-fifth of the size it used  
31 to be. It used to be the biggest brand in  
32 the market, now it's a relatively small

19616

1 brand.

2 The big brands -- I grew up in the  
3 1950s. And you look at who the big brands at  
4 that time were, Camel, Lucky Strike,  
5 Chesterfield, Pall Mall, Old Gold, those were  
6 big brands at that time. And all those  
7 companies -- all those brands have  
8 essentially disappeared. There's a little,  
9 just a little bit of sales, Lucky Strike,  
10 Chesterfield, Pall Mall, Old Gold. Those big  
11 brands hardly exist anymore.

12 So what's really interesting about this  
13 industry is that the brands, which consumer  
14 products really are the brands they sell, is  
15 that the brands that existed in 1950 have  
16 mostly all died. All of them essentially  
17 have died in terms of being really small  
18 other than Camels, which has taken a  
19 tremendous hit, going from 27 percent share  
20 to five percent share. And Kool has  
21 increased a little bit. That's the only one  
22 that's actually gone up. It was a small  
23 brand in 1950, it's a little bit bigger brand  
24 today. But the brands of the companies.

25 Now, think about other consumer

26 products. That's just not the case for  
27 consumers. It's not true for beer and soft  
28 drinks and bread and cereals and all sorts of  
29 things. Cheerios is still a big cereal  
30 today, as are Kellogg's Corn Flakes™. Most  
31 other consumer products of this kind, the big  
32 brands from the 1950s are still the big

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19617

1 brands.

2 In this industry, the competitive  
3 process essentially killed off the brands.  
4 These were all -- These were mostly all  
5 unfiltered, strong, high tar and nicotine  
6 cigarettes in 1950. And the result of moving  
7 to lower tar and nicotine products was  
8 essentially what killed off the brands of  
9 these companies.

10 QUESTION: I move to admit "Exhibit 6."

11 You mentioned the changes in both the  
12 brands and the market share over the last  
13 fifty years. What's the significance of this  
14 big change in market shares and brands to  
15 your opinion about competition in the  
16 cigarette industry?

17 ANSWER: Well, that's the clearest sign  
18 of the very, very strong nature of  
19 competition in this industry. Which  
20 companies rose and fell, the largest company  
21 disappeared, the small company rose to be the  
22 largest.

23 The brands of the companies, which are  
24 their most important competitive weapons have  
25 all, from the 1950s, have mostly all died and  
26 had to be replaced by new -- by new brands.  
27 This is the -- This is the destructive  
28 process that arises in really competitive  
29 industries.

30 QUESTION: And are these changes in  
31 market share and dominant brands consistent  
32 or inconsistent with competition?

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19618

1 ANSWER: They are the end result of very  
2 vigorous competition in the industry.

3 QUESTION: Okay. Doctor, plaintiffs'  
4 expert, Dr. Jaffe, has testified in his  
5 deposition in this case that each company in  
6 the cigarette industry agreed not to compete  
7 with respect to health issues in order to  
8 keep the status quo.

9 Do you agree with that conclusion?

10 ANSWER: No. My conclusion is exactly  
11 the opposite. What the companies did, again,  
12 back in the 1950s, what they were all  
13 overwhelmingly were producing was very high  
14 tar and nicotine cigarettes with no filters.  
15 And they very quickly moved to cigarettes  
16 with filters and cigarettes with much lower  
17 tar and nicotine and other constituents.

18 QUESTION: Okay.

19                   ANSWER: So that they let -- the  
20 competition was exactly about was trying to  
21 produce potentially safer products.

22                   QUESTION: Okay. Could you tell the  
23 jury whether, in your opinion, cigarette  
24 companies had incentives to develop safer  
25 products?

26                   ANSWER: Yes.

27                   QUESTION: And what were those  
28 incentives?

29                   ANSWER: Well, the companies had a  
30 tremendous incentive because of beginning  
31 with the Surgeon General's report in '64, we  
32 know and people strongly suspected before

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19619

1                   that that cigarettes -- smoking cigarettes  
2 posed a substantial health risk. So if the  
3 companies could have produced products which  
4 were actually, the Surgeon General would say,  
5 these are actually safe enough to smoke  
6 rather than just somewhat lower risk, we  
7 would have much more smoking today.

8                   Remember, almost 50 percent of adults  
9 smoked in 1950. Now we're in the low 20s, 22  
10 or 23 percent of Americans now, adults, smoke  
11 today. There would be many more smokers  
12 today if cigarettes had been able to be  
13 produced that were actually safe to smoke.

14                   QUESTION: Okay. And have you produced  
15 a chart to illustrate this point?

16                   ANSWER: Yes, I have.

17                   QUESTION: Dr. Scheffman, could you  
18 explain this chart to the jury and the  
19 significance it has to your opinions about  
20 the incentives that cigarette companies had  
21 to develop safer cigarettes?

22                   ANSWER: Yes.

23                   Again, what this has to do with is a  
24 central allegation in this case is an  
25 allegation that the companies conspired not  
26 to produce -- to try not to produce safer  
27 products. Okay. And what I've done here is  
28 this is another chart that has the years now  
29 going from 1945 up to 1998.

30                   And on this axis, instead of market  
31 share, I'm measuring essentially what sales  
32 in the U.S. of cigarettes are. So in 1945,

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19620

1                   there were 300 billion cigarettes -- an  
2 amount consistent with 300 billion individual  
3 cigarettes sold in 1945. This blue line  
4 shows what the trend in actual industry sales  
5 has been over time. Okay. It's going  
6 from -- It's increasing up through the early  
7 1980s and falling.

8                   If we look at other industries, if we  
9 look at other industries like for beer and  
10 soft drinks and things like that, we would  
11 have seen a trend that looked like this of

12 sales (indicating upward), that it's grown  
13 with the economy. In this industry, sales --  
14 the growth of sales went down because of the  
15 health problems of cigarettes. So this is  
16 the blue line of cigarette sales.

17 What I've done here is, say, suppose in  
18 1963 the companies had somehow been able to,  
19 by that time, hypothetically produce a  
20 product that the Surgeon General said, "Well,  
21 this new product is actually safe enough to  
22 smoke. It doesn't present a bigger danger  
23 than, say, drinking alcohol or other sorts of  
24 risks people take."

25 How much sales could the company --  
26 could the industry expect to get? And the  
27 way I've done that, how I've done that is  
28 supposedly looked at how much cigarette  
29 consumption there was per adult in 1963, and  
30 suppose that would have stayed the same going  
31 forward, and look at -- project what industry  
32 sales would have been.

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19621

1 So this red dotted line is what the  
2 industry -- one estimate of what industry  
3 sales could have been if the industry, say,  
4 in 1963 had somehow been able to come up with  
5 a product that the Surgeon General said, "No,  
6 this is safe enough to smoke."

7 And this results in, going back to 1963,  
8 if we use that -- if we use that as our  
9 estimate, the industry would have sold five  
10 trillion more cigarettes over the last  
11 thirty-five years, roughly. Or 151 billion  
12 cigarettes a year.

13 Now, this is just one measurement, but  
14 -- And we can summarize it that the industry  
15 today would be about twice as large as it  
16 actually is. In other words, it might have  
17 grown like the soft drink industry, which has  
18 continued to grow. Instead of going like  
19 this, the soft drink industry went like this  
20 (indicating upward).

21 So what this shows is that the companies  
22 in the industry had a tremendous incentive to  
23 try and come up with products, potentially  
24 safer products. That's why -- And they tried  
25 to do that. That's what killed the brands.  
26 That's what, in part, what killed American  
27 Tobacco, trying to produce lower tar and  
28 nicotine, lower risk products.

29 I'm not saying those products were safe.  
30 The Surgeon General said there isn't such a  
31 product, all cigarettes are unsafe.

32 But the companies clearly tried to

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19622

1 produce products that were potentially safer.  
2 So if they could have had this breakthrough  
3 product, say, in 1963 or 1983 or 1993, they  
4 could have expected to sell many more

5 cigarettes than they've actually been able to  
6 sell.  
7 QUESTION: Is this potential market data  
8 like you've shown on your chart the type of  
9 data used and generally relied upon by  
10 economists in evaluating competition?

11 ANSWER: Yes.

12 QUESTION: Okay. Move to admit "Exhibit  
13 7."

14 You mentioned brands and the  
15 introduction of brands as being an indication  
16 of competition. Have you prepared a chart to  
17 illustrate the brand varieties that have been  
18 introduced by these companies over the years?

19 ANSWER: Yes.

20 QUESTION: Okay. And showing you what's  
21 been marked as "Exhibit 8," could you explain  
22 what this chart shows?

23 (Whereupon the document as described  
24 above was marked as "Scheffman Exhibit  
25 Number 8.")

26 ANSWER: Okay. This chart is a little  
27 bit more complicated. Let me try to explain  
28 it. Again, we have -- This goes from 1950 up  
29 to 1970, okay? And this doesn't measure  
30 market share. This measures how many brands  
31 and types of products were available in the  
32 marketplace.

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19623

1 So, for example, in 1950, there were  
2 about 27 different products. There were a  
3 small number of brands. Those top ten brands  
4 I had on the earlier chart represented most  
5 of the sales in the industry. There  
6 weren't -- There weren't that many brands.

7 Now, so what this -- what these bar  
8 charts show as you go forward is how many  
9 total brands and varieties of products were  
10 available in the marketplace. And so we see  
11 starting in 1950, there's about 27. By 1970  
12 already, there's almost a hundred different  
13 products in the market.

14 What's going on here? What's going on  
15 here is that beginning in the early fifties,  
16 1952, companies are moving to put filters on  
17 cigarettes, companies are moving as they go  
18 over time putting better filters, using other  
19 techniques to reduce tar and nicotine, mainly  
20 producing lower tar and nicotine products.

21 So what we're seeing here is the growth  
22 of filter and lower tar and nicotine products  
23 so that we have many, many more products. We  
24 have in the industry over a hundred different  
25 varieties of products that are competing with  
26 one another in the marketplace already by  
27 1970. And as opposed to there were just a  
28 few, there were about a quarter as many in  
29 1950.

30 If we go forward to today, there's  
31 way -- there's over a thousand different  
32 varieties of products available in the

19624

1 marketplace. This is all a result of  
2 competing for developing new products. And  
3 the main competition here was developing new  
4 products that had lower tar and nicotine.

5 QUESTION: Okay. And just so I'm clear,  
6 the red for each year indicates the new  
7 brands or varieties introduced just in that  
8 year; is that right?

9 ANSWER: Yes.

10 This red here, like in 1952, these are  
11 -- these are largely filtered cigarettes  
12 which are beginning to be introduced. This  
13 period here is the beginning of the  
14 introduction of filtered cigarettes. And  
15 this area here are the first successful  
16 filtered cigarettes, like Winston, like  
17 L & M, et cetera, Marlboro which eventually  
18 becomes a very successful product, they're  
19 all introduced in this period here in the  
20 fifties.

21 QUESTION: I move to admit "Exhibit 8."  
22 Doctor, has there been potential  
23 competition from other sources to develop  
24 safer cigarettes other than just the  
25 companies here in the United States?

26 ANSWER: Yes.

27 QUESTION: And who have those -- what  
28 have those sources been, competition?

29 ANSWER: Well, going back to the 1950s,  
30 not just in the U.S., all across the world,  
31 there was publicity about the potential  
32 adverse consequences of smoking. You have

19625

1 the Surgeon General's report here in the U.S.  
2 in '64; the Surgeon General stated separately  
3 in the U.S. in '57; in places like Britain  
4 and Canada, the public health authorities  
5 spoke in the fifties and early sixties that  
6 there were serious problems with health  
7 problems probably arising from smoking.

8 So we had all across the world, we had  
9 government entities, we had university  
10 professors, public health researchers,  
11 scientists going back to the 1950s have been  
12 working all across the world in trying to  
13 develop a product that was potential -- that  
14 was potentially safe.

15 QUESTION: Are foreign cigarette  
16 companies able to market their cigarettes in  
17 the United States?

18 ANSWER: Yes.

19 QUESTION: Okay. Would these foreign  
20 cigarette companies have the same incentives  
21 and reasons as the United States cigarette  
22 companies to develop safer cigarettes?

23 ANSWER: Yes.

24 Like if we go back to the 1950s, there  
25 are major cigarette companies -- and there

26 still are -- all across the world. Japan  
27 Tobacco is one of the biggest cigarette  
28 companies in the world. There are large  
29 cigarette companies in Germany and France and  
30 Italy and Spain and various other places  
31 across the world that aren't U.S. companies.

32 QUESTION: Now, Dr. Scheffman, do you  
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19626

1 really need a sophisticated analysis to  
2 conclude that there was incentive for the  
3 U.S. cigarette companies to make cigarettes  
4 that were accepted as safer?

5 ANSWER: Yes, I think it's -- Well, as a  
6 matter of economics, I think it's just common  
7 sense. It was clearly in the companies' and  
8 the industry's interest to try and come up  
9 with a product -- come up with products that  
10 were safe. Because everyone would have been  
11 able to sell more, a lot more cigarettes than  
12 they have come to been able to sell.

13 QUESTION: Let's go back for a minute to  
14 your references to the development of low tar  
15 and filtered cigarettes.

16 Have you prepared a chart that shows  
17 what's happened to the sales of filtered  
18 cigarettes and low-tar cigarettes over time?

19 ANSWER: Yes.

20 QUESTION: And what does what we've  
21 marked as "Exhibit 9" show?

22 (Whereupon the document as described  
23 above was marked as "Scheffman Exhibit  
24 Number 9.")

25 ANSWER: Okay. Well, this is our  
26 friend, another 1950 to 1994 here are the  
27 years. And these are percentages, they're  
28 not market share. What these percentages,  
29 and we still have the six companies like that  
30 other -- like that other diagram with all the  
31 colored pictures, so it's something like  
32 that. But we're not measuring the market

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19627

1 share of the companies.

2 What we're measuring is what percentage  
3 of the company sales were filtered  
4 cigarettes, okay? So, for example, if you go  
5 back to 1950, hardly any cigarettes were sold  
6 had filters. They were all strong cigarettes  
7 with no filters on them. Brown & Williamson  
8 had Viceroy, a filtered cigarette. But there  
9 were hardly any sales of filtered cigarettes.

10 Now, what happened was this period in  
11 the early fifties is the beginning of a lot  
12 of publicity in the media about that maybe  
13 smoking is dangerous for the first time. And  
14 it was widely communicated to the public in  
15 Reader's Digest and television and other  
16 things like that that there might be smoking  
17 -- there might be health problems, serious  
18 health problems, arising from smoking.



19                   What happened is that the companies very  
20                   quickly developed products that had filters.  
21                   So you see here that -- Here's Liggett. They  
22                   have essentially no sales of products with  
23                   filters in 1952. And you see that almost 50  
24                   percent of their sales by '58 are filtered  
25                   cigarettes. They introduced one of the first  
26                   successful filtered cigarettes, L & M, okay?  
27                   We see R. J. Reynolds, the same. They  
28                   introduced the most -- what was for a long  
29                   time the most successful filtered cigarette,  
30                   the Winston was introduced. And their sales  
31                   very quickly of filtered cigarettes jumped to  
32                   over 50 percent.

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19628

1                   So what's interesting about this chart  
2                   is, one, the companies reacted very quickly,  
3                   as you expect they would. Filters, filters  
4                   are probably the singlemost important element  
5                   in reducing tar and nicotine in a cigarette.  
6                   And the companies very quickly added filters.  
7                   And then they very quickly over time added  
8                   more effective filters and other techniques  
9                   which actually reduced tar and nicotine.

10                  And the reason why they did that is that  
11                  what was being reported to the public is  
12                  lower tar and nicotine was potentially safer.  
13                  So most companies moved very quickly.

14                  Now, what's interesting is the standout  
15                  here, American Tobacco. Now, remember,  
16                  American Tobacco was the biggest company in  
17                  1950. And, remember, they no longer exist  
18                  today. They're the outlier. They had --  
19                  They had strong brands that were all  
20                  nonfiltered cigarettes, and they essentially  
21                  stuck with those and pushed those products.

22                  And their percentage of their sales that  
23                  were filters, so they have -- they didn't  
24                  reach -- the point where 50 percent of their  
25                  sales were filtered cigarettes was in the  
26                  1970s. That's really quite remarkable.  
27                  Say in 1974, still 50 percent of their sales  
28                  were unfiltered cigarettes. Where,  
29                  overwhelmingly, most sales during that time  
30                  were filtered products for the competition.

31                  So they were very slow in their efforts.  
32                  They stuck with -- They had strong brands,

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19629

1                   they had loyal smokers. But the market left  
2                   them behind. The competitors successfully  
3                   introduced filtered cigarettes. They didn't.

4                   And this was the beginning of the reason  
5                   why American Tobacco faded. You remember its  
6                   share went from 33 down to essentially zero.  
7                   That was a fundamental reason why that's  
8                   true. They didn't -- They didn't compete as  
9                   vigorously on trying to produce potentially  
10                  safer products.

11                  QUESTION: Okay. I move to admit

12 "Exhibit 9."  
13 Doctor, have you also prepared another  
14 chart that shows the introduction of filter  
15 versus nonfilter cigarette sales over this  
16 time?  
17 ANSWER: Yes.  
18 QUESTION: And what does this chart show  
19 the jury?  
20 ANSWER: This shows for the -- This is  
21 the same chart, same years, same percentage,  
22 which is percentage of filters. This puts it  
23 all together for the industry. So this says  
24 -- The red line here is what percentage of  
25 sales were nonfiltered cigarettes.  
26 So, again, if we go to 1950 -- this is  
27 for the industry as a whole -- in 1950,  
28 almost a hundred percent of the sales in the  
29 industry were nonfilters. And that very  
30 quickly falls. This blue chart is what  
31 percentage of the sales were filters.  
32 So for those of you mathematically  
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19630

1 inclined, of course, these numbers add up to  
2 be a hundred percent. The percentage  
3 nonfilters and the percentage filters would  
4 add up to be a hundred. So we see this rapid  
5 decline of nonfilters and this very rapid  
6 increase in filters.  
7 This tremendous move in the industry in  
8 a very short period of time where for years  
9 and years people had smoked cigarettes that  
10 didn't have filters, that were full strength,  
11 very high tar and nicotine. And they very  
12 quickly, the industry very quickly moved to  
13 introducing products successfully that had  
14 filters and lower tar and nicotine.  
15 So that by 19 -- by the late 1950s,  
16 already more than 50 percent of sales in the  
17 marketplace were filtered cigarettes. And  
18 today, of course, and for many years, you  
19 know, going back to the late seventies  
20 onward, more than 90 percent of sales are  
21 nonfilters. And today almost a hundred  
22 percent of sales are filtered cigarettes.  
23 QUESTION: Okay. I move to admit  
24 "Exhibit 10."

25 Doctor, you mentioned the rapid move to  
26 filtered cigarettes. Are you familiar with  
27 Dr. Wynder's recommendation in 1957 that the  
28 companies reduce their tar levels in  
29 cigarettes by 40 percent?  
30 ANSWER: Yes.  
31 Dr. Wynder was one of the leading public  
32 health researchers on smoking and health. It  
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19631

1 was some of his early studies in the early  
2 1950s were the beginning of what we later  
3 understood to be the fact that smoking had  
4 serious health consequences.

5           So in 1957, he wrote a paper; he also  
6 testified in front of the U.S. Congress. And  
7 his opinion at that time was -- and this is  
8 published, this is an extract from his  
9 article -- but he says that "It seems  
10 feasible to produce a filter that will remove  
11 40 percent of the tar from a given  
12 cigarette." That it's possible.

13           And that if we're able to do that and if  
14 people moderate their smoking habits, this  
15 "...can effectively reduce the cancer risk of  
16 smokers." That is, lower the tar level,  
17 moderate smoking behavior, then we can  
18 effectively reduce the cancer risk of  
19 smokers.

20           This was widely publicized at the time.  
21 And he and a number of other prominent public  
22 health authorities, including the Surgeon  
23 General, said smoking's unsafe. But if  
24 you're going to smoke, you should smoke less  
25 and you should try and smoke lower tar and  
26 nicotine products.

27           And he was the one, specifically on the  
28 basis of his scientific research, concluded a  
29 reduction in tar levels of 40 percent might  
30 produce an acceptably risky -- an acceptably  
31 risky product.

32           QUESTION: Okay. Doctor, have you  
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19632

1           prepared a chart showing when the cigarette  
2 companies accomplished that goal of reducing  
3 the tar content by 40 percent?

4           ANSWER: Yes.

5           QUESTION: And what does this chart  
6 show?

7           ANSWER: Okay. This is a chart --  
8 Again, it has years at the bottom, this time  
9 going from 1957 up to the late nineties. And  
10 what this measures here is not market share.  
11 It measures the tar, how much the measured  
12 tar is in particular cigarettes.

13           And we have three measures, okay? One  
14 of which is minimum tar. What this measures  
15 is for the lowest tar cigarette available in  
16 the marketplace, what's the level of measured  
17 tar. So we all see, in cigarettes, we see in  
18 their advertisements, we see what the, if you  
19 look at an advertisement for a cigarette,  
20 you'll see what the measure of tar is.  
21 That's what this is.

22           So we asked, this first thing, the  
23 "Minimum Tar" says what is -- what's the tar  
24 of the lowest tar product available in the  
25 marketplace. Now, you see back in 1957, the  
26 lowest tar product was about 26 milligrams.  
27 That's way above the cigarettes that are  
28 being consumed today and have been for many  
29 years.

30           And you see already by 1959, the minimum  
31 tar product was -- went from 26 down to about  
32 7. In other words, already beginning very

19633

1 quickly after Dr. Wynder's statement and a  
2 lot of publicity to the consumers about  
3 reduce tar by 40 percent, products were  
4 introduced in the marketplace that  
5 dramatically reduced the tar. And then this  
6 tar reduction continues onward.

7 These dotted lines here is that there's  
8 not data, there aren't data available -- and  
9 I'll talk about that a little later --  
10 between 1960 and 1967, roughly, there isn't  
11 data available for the minimum tar product.  
12 But these products continued to be in the  
13 marketplace. And we've sort of drawn a  
14 dotted line in between.

15 So what we've seen going back to 1957,  
16 in two years, there were products available  
17 that reduced the tar level way more than 40  
18 percent, okay? Companies introduced those.

19 Second, this second line here is the  
20 "Weighted Average Tar." Now, what does that  
21 mean? That is if we look at sort of what the  
22 tar of the cigarette the average smoker is  
23 smoking, average across smokers, so some  
24 smokers are smoking high-tar products, some  
25 are smoking low-tar products, we average them  
26 all together, and this is a measure of sort  
27 of what the average smoker is smoking.

28 And we see that the weighted average tar  
29 of the average smoker was about 37  
30 milligrams, very high in 1957 still. And  
31 that very rapidly fell, also. So this  
32 measure of what the average smoker is smoking

19634

1 fell very rapidly. And very quickly Dr.  
2 Wynder's projection that cigarettes that did  
3 reduce tar by 40 percent could be produced  
4 and that might lower the risk of smoking was  
5 achieved very quickly, all right? And so we  
6 see this decline.

7 This is what people -- This reflects  
8 what's available in the marketplace and what  
9 people actually choose to smoke. Low, very  
10 low-tar cigarettes were available very early  
11 on but it took time for people to get used to  
12 lower tar products.

13 So this reflects a combination of what  
14 was available in the marketplace and what  
15 people chose to consume to smoke. And we see  
16 this decline in tar, weighted average tar, so  
17 that today -- so that today it's around the  
18 order of about 12 to 13 milligrams, where it  
19 was 37 in 1957.

20 Finally, this last chart here is what's  
21 the maximum tar cigarette. Remember, there  
22 were things -- products like Old Gold  
23 unfilters, we had tar ratings up above 40, up  
24 near 45 in 1957. And we see that that, even  
25 the highest tar products, which are mainly

26 the -- which are the nonfiltered products,  
27 have fallen very substantially over time.  
28 So this shows two things. One, the  
29 industry acted -- reacted very quickly to the  
30 public information that was available, that  
31 was communicated throughout to most Americans  
32 in the Reader's Digest and other things that  
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19635

1 you should, if you're going to continue  
2 smoking, you should switch to lower tar and  
3 nicotine products.

4 The companies very quickly introduced  
5 products that had lower tar and they  
6 advertised them extensively. And consumers  
7 quite quickly switched and moved their  
8 smoking behavior to smoke lower yield  
9 products.

10 QUESTION: Thank you, Doctor.

11 I move to admit the last two exhibits.

12 Dr. Scheffman, how does the reduction in  
13 tar and nicotine in cigarettes in the United  
14 States compare with what was happening in  
15 other countries around the world at that  
16 time?

17 ANSWER: Okay. Well, there have been  
18 studies of that. And what's interesting is  
19 that if you look across countries, the U.S.  
20 led the world. The U.S. companies and the  
21 U.S. industry led the world in introducing  
22 lower tar and nicotine products and in  
23 driving down the level of tar in cigarettes  
24 that people smoke. The U.S. led all the  
25 other major countries in the world by about  
26 ten to fifteen years in driving down the tar  
27 and nicotine.

28 Because the movement -- there was a  
29 movement in the U.S. which was much faster to  
30 filters and much faster in utilizing filters  
31 that actually reduced tar and using other  
32 techniques to reduce tar. So it's well-known

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19636

1 in the scientific literature that the U.S.  
2 led most other major countries in the world  
3 in introducing products and in actually the  
4 tar and nicotine level of products smoked by  
5 American smokers going down much faster in  
6 the U.S. than most other countries.

7 QUESTION: Have you compared foreign  
8 countries' tar and nicotine levels with those  
9 of cigarettes in the United States?

10 ANSWER: Yes.

11 QUESTION: And what does that comparison  
12 between the tar and nicotine reduction of  
13 American cigarettes versus foreign cigarettes  
14 tell you about the nature of competition in  
15 the United States?

16 ANSWER: Well, one way that economists  
17 assess competition is if you have an industry  
18 in which you have different industries in

19 different parts of the world, like you have a  
20 cigarette industry in the U.S. and you have a  
21 cigarette industry in Britain and a cigarette  
22 industry in Germany and a cigarette industry  
23 in France, one important way an economist  
24 assesses this extent of competition is  
25 compare the different industries.

26 Now, what happened -- The two striking  
27 things that are different in the U.S. from  
28 other, most other industries, too, those --  
29 I'm comparing here the cigarette industry in  
30 the U.S. with the cigarette industry in  
31 Britain, the cigarette industry in Germany,  
32 the cigarette industry in France, the

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19637

1 cigarette industry in Spain, the same  
2 industry in different places.

3 And that's a very important technique  
4 economists use that we call benchmarking as  
5 an assessment of competition.

6 Now, there are two very important things  
7 that leap out when you look at that. One, if  
8 you look at that change in market share, that  
9 tremendous change in market share in the U.S.  
10 and all those brands being killed off, that  
11 was veritably unique.

12 It didn't happen in Britain, didn't  
13 happen in France, didn't happen in Spain,  
14 didn't happen in Germany, didn't happen in  
15 hardly any other country in the world, this  
16 tremendous volatility in market share. In  
17 most cases, the big companies in 1950 are  
18 still big cigarette companies today in most  
19 other places in the world.

20 Second, when you look at the performance  
21 in terms of adding filters and lowering tar  
22 and nicotine, the U.S. led most of the rest  
23 of the world, being much faster in lowering  
24 tar and nicotine levels in cigarettes than  
25 the rest of the world. That's the -- That is  
26 the nature of competition.

27 The U.S., as in most industries, the  
28 U.S. is much more competitive. The cigarette  
29 industry was much more competitive here than  
30 elsewhere, both in -- measured by its  
31 volatility in market share and both in  
32 responding to the health concerns about

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19638

1 cigarettes and introducing lower yield  
2 products.

3 By that measure, when we measure --  
4 when we look at an industry and we say it's  
5 competitive and then we say, "Well, how  
6 competitive is it? Is it really competitive  
7 or is it moderately competitive?" One of the  
8 best measures of that is to compare the same  
9 industry in different areas of the world or  
10 different areas of the country.

11 By that test, the U.S. industry is

12 clearly the most competitive industry of the  
13 major countries in the world.

14 QUESTION: Doctor, have you looked into  
15 whether American companies made other efforts  
16 other than filter and low-tar cigarettes as  
17 part of product innovation?

18 ANSWER: Yes.

19 QUESTION: Can you summarize briefly for  
20 the jury some of the other areas in which the  
21 companies competed as part of cutting tar and  
22 nicotine levels?

23 ANSWER: Yes.

24 Well, I'm speaking as a scientist. But  
25 as studying product innovation here, the  
26 health problems of cigarettes are posed by  
27 the products that come in the smoke that you  
28 inhale. So there's tar and then there's  
29 various gas sort of things that come out of a  
30 cigarette.

31 Now, we know that what the companies  
32 did, and this is in the company documents and  
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19639

1 it's well-established in the scientific  
2 literature --

3 Okay.

4 But if you study the product innovation  
5 in this industry, there were a number of  
6 things the companies did that reduced tar and  
7 nicotine.

8 And that was use of filters,  
9 increasingly effective filters; use of paper,  
10 paper that added more air, more aeration, use  
11 of aeration, putting holes in filters and  
12 paper; using expanded tobacco, tobacco that  
13 you pop up like sort of popcorn so it uses up  
14 more space so that a cigarette has less  
15 tobacco in it; reconstituted tobacco, which  
16 is using more of the stem of the tobacco  
17 plant instead of the leaf, which has -- and  
18 the stem has less harmful constituents in it.

19 So all those things were done, along  
20 with various things having to do with tobacco  
21 itself, which led to lower tar, lower  
22 nicotine and lower other constituents.  
23 That's all documented in the 1981 Surgeon  
24 General's report that surveyed all what had  
25 happened. It's called -- The title of the  
26 report, if I recall, was "A Changing  
27 Cigarette."

28 Other companies pioneered the  
29 development of filters. Other companies  
30 pioneered the development of reconstituted  
31 and expanded tobacco. Other companies  
32 pioneered the development of charcoal

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19640

1 filters. These were all American companies  
2 that did these things and that which led to  
3 the, again, the U.S. leading the world in  
4 terms of other major countries in developing

5 low-yield products.

6 QUESTION: Now, did you look into  
7 whether all of these other efforts you've  
8 just described were successful?

9 ANSWER: Well, yes, I did.

10 And a number of the companies tried lots  
11 of different things, as they do in -- as I've  
12 looked at in a lot of other industry  
13 settings. The obvious problem in this case  
14 was a product that was harmful. And the  
15 issue -- And the problem was to try and  
16 develop a product that produced less harmful  
17 substances.

18 And there were both technical and  
19 marketing problems for the companies in both  
20 being able to achieve reduction of certain  
21 substances, and another problem was getting  
22 consumer acceptance of very low-yield  
23 products. The companies very quickly  
24 developed quite low-yield products. But  
25 really low-yield products don't gain much  
26 consumer acceptance because they don't smoke  
27 like regular cigarettes.

28 QUESTION: Now, is it unusual for  
29 companies to introduce or try to introduce  
30 new products and have those products not be  
31 successful in the marketplace?

32 ANSWER: Not at all. I've studied  
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19641

1 product innovation for consumer products  
2 specifically extensively. And it's well  
3 known that anywhere between eight and nine of  
4 every ten new consumer products that are  
5 introduced fail in the marketplace. And many  
6 more fail that don't get to the marketplace.  
7 So failure is part of the process, the  
8 product innovation process. There's a high  
9 failure rate.

10 QUESTION: Why is that?

11 ANSWER: There's technical problems.  
12 The technical problem, of course, for the  
13 cigarette industry is no one's figured out  
14 how to produce a product that's anything like  
15 a cigarette from a consumer perspective that  
16 is acceptable risk, that is an acceptable  
17 risk product, despite efforts all across the  
18 world to do it. So, in part, it's technical.

19 In part, it's consumer acceptance.  
20 People know, for example, that a high-fat  
21 diet is bad for a lot of people.  
22 Nonetheless, and although there's been a  
23 growth of low-fat products, still people  
24 consume primarily more higher fat, higher  
25 sugar products because there's a consumer  
26 acceptance issue.

27 QUESTION: Doctor, did the cigarette  
28 industry also work with well-known scientists  
29 and public health authorities on smoking and  
30 health issues over the years?

31 ANSWER: Yes, they did.

32 QUESTION: What examples of that did you



19642

1 see in your research?

2 ANSWER: Well, one interesting example  
3 is Lorillard, Dr. Spears, who was the head  
4 scientist of Lorillard and then eventually  
5 went on to be the head of the Lorillard  
6 Company, cigarette company, is largely  
7 regarded as the leading scientist within the  
8 cigarette companies.

9 And Lorillard worked, going back to the  
10 1960s, worked with Dr. Wynder. Dr. Spears  
11 and Dr. Wynder actually worked together to  
12 try and develop potentially safer products.

13 Liggett worked with A. D. Little, which  
14 was a major scientific consulting company,  
15 they worked for years with A. D. Little to  
16 try and develop safer products.

17 All the companies worked with various  
18 consultants and companies. A lot of the  
19 developments in filters and papers came from  
20 working with filter -- companies that produce  
21 filters and papers, worked with scientific  
22 experts on public health authorities, and  
23 with companies that produce papers and  
24 filters and other things.

25 So the industry, as in most industries,  
26 worked with a lot of scientific authorities  
27 outside the companies to try and develop  
28 potentially safer products.

29 (Whereupon the playback of the above-  
30 referenced videotape is paused at this time.)

31 THE COURT:

32 We will recess until 11:00 by the wall

19643

1 clock for our morning recess.

2 (Whereupon the jury is excused at this  
3 time.)

4 THE COURT:

5 Let the record reflect the jury has left  
6 the courtroom.

7 Anything for the record by plaintiffs'  
8 counsel?

9 MR. RUSS HERMAN:

10 Yes, Your Honor.

11 Your Honor, if anything at all ever  
12 demonstrated why advertising dollars are an  
13 important issue in this case, Mr. Scheffman's  
14 testimony does.

15 Early in his testimony, he put up a  
16 chart, "U.S. Cigarette Industry Market Share  
17 of Unit Sales," showing market share  
18 increased from 1950 to 2000, then went to  
19 Maxwell reports of market shares, then  
20 introduced other information to show the rise  
21 or fall or decline of certain brands.

22 That issue cannot be divorced from how  
23 much money each one of these companies was  
24 spending on advertising. Were we allowed to  
25 introduce the relevant information of how

26 much money was Philip Morris was spending on  
27 advertising, for example, 400 million dollars  
28 a year at some point, where R. J. Reynolds  
29 was only spending 30 million dollars, it  
30 would account for a substantial rise in  
31 market share.

32 What this witness has done, Dr.

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19644

1 Scheffman, has taken one-half of a picture to  
2 show to the jury and actually cropped a  
3 photograph. It's an interesting defense  
4 technique. You take a photograph of an  
5 entire picture; and if you don't like part of  
6 it, you slice it off and then show it as if  
7 it's the whole.

8 Since we have not been allowed -- and we  
9 must accept Your Honor's ruling, we've  
10 reserved our rights to it but we must accept  
11 it -- we indicate now for the record through  
12 the introduction of this testimony by the  
13 defense as a primary and fundamental defense  
14 that they have waived any arguments, any  
15 notions, any rights as to the issue of  
16 advertising preemption and as to what they  
17 have erroneously and continuously raised to  
18 this Court as some First Amendment bugaboo as  
19 to advertising.

20 What significantly makes this case  
21 different from any other tobacco case and any  
22 other consumer fraud or conspiracy case at  
23 this juncture is that the defense has been  
24 allowed to compare research dollars that  
25 they've spent and produced economists on  
26 advertising and marketing issues without  
27 disclosing the impact that advertising  
28 dollars make on market share. That cuts  
29 across directly their preemption arguments,  
30 any First Amendment arguments or  
31 constitutional arguments they have because  
32 they have now fundamentally put the issue, as

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19645

1 they did in our case on cross-examination,  
2 before The Court.

3 So we make that issue of waiver at this  
4 juncture, not as a continuing objection on  
5 advertising dollars, but for purposes of  
6 indicating that Your Honor was absolutely  
7 correct when you ruled that there was not a  
8 preemption issue and when Your Honor ruled  
9 that there was not a First Amendment issue in  
10 the construct the defendants raised. And now  
11 those issues have been waived by the evidence  
12 presented by the defendants.

13 THE COURT:

14 Anything else by plaintiffs' counsel?

15 MR. RUSS HERMAN:

16 No, Your Honor.

17 THE COURT:

18 Any response?

19 MR. WITTMANN:  
20 Yes, Your Honor.  
21 I don't understand why we have to listen  
22 for the tenth time to arguments Mr. Herman  
23 conjures up during the course of the morning  
24 session. If he's got some motion he wants to  
25 bring, let him bring it. But we're treated  
26 on a regular basis to a spontaneous outburst  
27 from Mr. Herman, which is completely contrary  
28 to Your Honor's prior rulings in this case.  
29 I think it's a waste of our time and a waste  
30 of The Court's time.

31 THE COURT:  
32 Anything else by defense counsel?  
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19646

1 We will recess until 11:00 o'clock by  
2 the wall clock.  
3 (Whereupon a brief recess was taken at  
4 this time from 10:49 o'clock a.m. to 11:02  
5 o'clock a.m.)  
6 THE BAILIFF:  
7 All rise for the jury, please.  
8 (Whereupon the jury joins the  
9 proceedings at this time.)  
10 THE MINUTE CLERK:  
11 All rise, please. Recess is over.  
12 Court will come to order. Please be seated.  
13 (Whereupon the playback of the above-  
14 referenced videotape is resumed at this time  
15 as follows:)  
16 QUESTION: Have you seen any evidence  
17 whether the companies are still trying, even  
18 today, to develop potentially safer  
19 cigarettes?

20 ANSWER: Yes.  
21 Both the public information and what  
22 I've seen of testimony of company officials  
23 in other cases indicates that the product --  
24 the companies all have projects underway to  
25 try and develop breakthrough or potentially  
26 safer products.  
27 QUESTION: Dr. Scheffman, have you seen  
28 evidence that the cigarette companies worked  
29 with the federal government over the years to  
30 develop safer cigarettes?

31 ANSWER: Yes.  
32 QUESTION: And what evidence did you see  
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19647

1 of that?  
2 ANSWER: Well, there was actually a  
3 federal government entity that was set up  
4 with the National Cancer Institute and others  
5 that was called the Tobacco Working Group.  
6 And it was set up explicitly, the federal  
7 government and a task force to work with  
8 public health officials, scientists,  
9 government people like the National Cancer  
10 Institute and other people in the federal  
11 government and with the cigarette companies.

12 And it was set up explicitly to try and  
13 develop potentially safer products. This was  
14 set up in about 1968. And it went on for  
15 about -- it went on for about ten years.

16 QUESTION: Was the Tobacco Working Group  
17 able to create a successful safe cigarette?

18 ANSWER: No, it wasn't.

19 QUESTION: Okay. And does the Tobacco  
20 Working Group still exist today?

21 ANSWER: No, it didn't -- doesn't.

22 QUESTION: How is the Tobacco Working  
23 Group relevant to your analysis in this case,  
24 Dr. Scheffman?

25 ANSWER: Well, it indicates a couple  
26 things. Which it's, again, very important to  
27 keep in mind that not just these cigarette  
28 companies but lots of entities all across the  
29 world, government entities, public health  
30 researchers, scientists, cigarette companies  
31 in other parts of the world have all been  
32 working for decades now to try and develop a

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19648

1 safer product. That's one thing.

2 Two, we had a ten-year -- we have this  
3 ten-year history of the U.S., of the federal  
4 government working with the cigarette  
5 companies and with scientists and everything  
6 explicitly for the purpose of trying to  
7 develop a potentially safe product. And the  
8 problem is -- and a lot was learned, a lot of  
9 research, areas were pursued -- but to this  
10 date, no one has figured out how to produce a  
11 cigarette that is acceptably safe.

12 QUESTION: Doctor, I'm now going to ask  
13 you some questions about some of the  
14 companies' efforts to develop a safer  
15 cigarette. The first is called Premier.

16 Are you familiar with that?

17 ANSWER: Yes, I am.

18 QUESTION: Okay. And could you tell the  
19 jury what your understanding is of the  
20 Premier product?

21 ANSWER: The Premier product, the idea  
22 of the Premier product was to try and produce  
23 a smoking -- a cigarette type product but one  
24 in which the tobacco was not actually burned.  
25 The idea being if the tobacco wasn't burned,  
26 you wouldn't have the same sort of heat and  
27 chemical processes and you wouldn't  
28 necessarily produce the same sort of  
29 chemicals in the same amounts that cigarette  
30 smoke in regular cigarettes produced.

31 So Premier was actually a very  
32 complicated product. I talked to some of the

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19649

1 RJR scientists about the product and I've  
2 read -- there's been a lot of published  
3 research on it. It was a product that looked  
4 like a cigarette but it actually had a metal

5 tube inside the cigarette which had things, a  
6 lot of things within the metal tube. It had  
7 sort of a carbon thing on the end which  
8 looked like it was burning like a cigarette  
9 but was actually just smoldering like  
10 charcoal.

11 And the idea was it had a tobacco-type  
12 product in it that was heated as a result of  
13 the product. And as a result of that, it was  
14 a cigarette-type product, you'd light it and  
15 you'd inhale, but you wouldn't be inhaling  
16 burning tobacco.

17 QUESTION: Was this a Reynolds project?

18 ANSWER: Yes.

19 QUESTION: Now, did you study what  
20 Reynolds did to market Premier?

21 ANSWER: Yes, I did.

22 QUESTION: And what did you learn?

23 ANSWER: What I learned is Reynolds did  
24 a number of things. And among the most  
25 important of what they did is Reynolds, the  
26 Reynolds people went to the public health  
27 authorities and the health scientists. And  
28 they had done a lot of research on Premier.  
29 And they went to tell the story of Premier,  
30 show them the science on Premier, show that  
31 it was a potentially safer product.

32 That was the most important thing.

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19650

1 Because Reynolds, if it wasn't going to get  
2 the endorsement of prominent public health  
3 authorities, was not likely to have much  
4 success in selling such a product. So the  
5 first step they did is go to the public  
6 health authorities, go to people like Dr.  
7 Wynder and others, tell the story of Premier,  
8 here's a unique breakthrough product, here's  
9 the science for it.

10 Reynolds published a whole large volume  
11 that had summarized the scientific studies  
12 that Reynolds had done and had done with  
13 contractors to try and communicate to the  
14 public health authorities and prominent  
15 scientists and government officials the  
16 Premier story, that this was a potentially  
17 lower risk product. That's the first thing  
18 they did.

19 Second, they talked to the media and  
20 tried to tell the story to the media about  
21 the Premier product.

22 And, third, they introduced the product  
23 out in the marketplace. And they  
24 communicated to the public through the media  
25 and through the advertising about the Premier  
26 product.

27 QUESTION: Now, did Reynolds'  
28 advertising of Premier tell people what the  
29 product was?

30 ANSWER: In a general way, the way  
31 advertising does, yes.

32 QUESTION: And have you brought a board

19651

1 illustrating the advertising for Premier?

2 ANSWER: Yes.

3 QUESTION: Could you explain what we've  
4 marked as "Exhibit 13" to the jury, please?

5 ANSWER: Yes.

6 This is one of the ads that Reynolds ran  
7 for the Premier product. And you'll see it  
8 tells it in simple terms. You know,  
9 advertisements don't have long pages of  
10 discussion, of course; they have a short,  
11 relatively short blurb that you try and  
12 communicate to consumers in a brief way what  
13 the product is about.

14 So, you see, Premier is a product that  
15 "you actually smoke by heating tobacco, not  
16 burning." That was the fundamental property  
17 of the Premier product. This doesn't burn  
18 tobacco; it heats it. And that the effect of  
19 that is that a product that doesn't burn  
20 cigarettes, according to all the scientific  
21 studies Reynolds did, found it substantially  
22 reduces many of the controversial compounds  
23 found in the smoke of tobacco-burning  
24 cigarettes.

25 That is, of course, from an advertising  
26 perspective. That's the way you'd expect an  
27 advertiser to say this is a unique product,  
28 it might be potentially safer, at least has  
29 less -- it has less controversial compounds  
30 found in the smoke of tobacco-burning  
31 products.

32 So it conveys very clearly this is just  
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19652

1 -- this is not just another low tar and  
2 nicotine product. This is a very different  
3 product. It doesn't even burn the tobacco;  
4 it just heats it. And it has less  
5 controversial -- less, quote, "controversial  
6 compounds."

7 So, again, what Reynolds did was try and  
8 communicate to the public, one, first by  
9 going to the public health community and  
10 scientists; second, going to the media which  
11 would report -- When you do a product launch,  
12 you always go to the media and you tell --  
13 The product launch for Premier was, if I  
14 recall right, in Arizona. You go to the  
15 local media and you tell the story, "Here's  
16 what Premier is about." This is fun. You  
17 hope to get stories in the media to say,  
18 "Here's this new product that does this new  
19 thing." You get, quote, free publicity,  
20 hopefully. And then you advertise.

21 QUESTION: Okay. I move to introduce  
22 "Defendants' 13."

23 Did Reynolds attempt to convince the  
24 public health community to support Premier?

25 ANSWER: Yes. It engaged -- It spent a

26 lot of efforts over a long period of time  
27 meeting with whoever would talk to them in  
28 the public health community and scientists  
29 about the Premier product.  
30 QUESTION: And what was the reaction of  
31 the public health community to Premier?  
32 ANSWER: The public -- The reaction of  
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19653

1 the public health community to and of the  
2 media to Premier was extremely negative.  
3 QUESTION: Have you brought boards to  
4 demonstrate the reaction of the public health  
5 community?

6 ANSWER: Yes.

7 QUESTION: What does this first board,  
8 which we've marked as "Exhibit 14" show?

9 (Whereupon the document as described  
10 above was marked as "Scheffman Exhibit  
11 Number 14.")

12 ANSWER: Okay. This is an excerpt from  
13 a media -- from Reuters, from a media news  
14 service, a story about the Premier product  
15 and about the Food and Drug Administration,  
16 the FDA. The Food and Drug Administration is  
17 the federal agency that regulates drugs on  
18 pharmaceuticals.

19 And this was what was reported in the  
20 press, that --

21 MR. MURRAY:

22 Your Honor, may we approach?

23 (Whereupon the playback of the above-  
24 referenced videotape is paused at this time.)

25 MR. MURRAY:

26 Our monitors are off.

27 (Whereupon a discussion was held off the  
28 record.)

29 MR. RUSS HERMAN:

30 Your Honor, maybe instead of losing  
31 time, we'll just watch the screen till this  
32 gets remedied. Is that all right? And that

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19654

1 way we can just move on.

2 THE COURT:

3 Oh, you mean play it --

4 MR. RUSS HERMAN:

5 Yes, we'll just watch this without  
6 watching the monitor. That will just move  
7 this along, if that's all right with  
8 everybody.

9 (Whereupon the playback of the above-  
10 referenced videotape is resumed at this time  
11 as follows:)

12 ANSWER: -- the Reuters person  
13 interviewed the FDA. And the FDA person  
14 says, "I don't think it would be given much  
15 of a chance to be shown safe." And this is  
16 what's reported to the public. This is what  
17 the news services are reporting. "It's  
18 pretty widely established that cigarettes are

19 hazardous. It would be assumed it would not  
20 be able to be marketed."

21 This is -- They're quoting a person at  
22 the federal -- Food and Drug Administration,  
23 which was the federal agency responsible for  
24 regulating drugs and hazardous substances.

25 QUESTION: Did also -- Did other public  
26 health authorities also weigh in on the  
27 Premier and respond publicly to its  
28 introduction?

29 ANSWER: Yes.

30 QUESTION: And what does this next board  
31 show us?

32 ANSWER: Now, this is a story that was  
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19655

1 in The Times-Picayune in November of '88.  
2 This is when -- This is in the period when  
3 Premier was being test marketed but not in  
4 Louisiana. It was being test marketed in  
5 Arizona. And what was being reported was  
6 that "The nation's largest medical  
7 association," that's the American Medical  
8 Association, sought publicly to halt  
9 distribution, to stop Premier, "until it's  
10 judged to be 'safe for human consumption.'"

11 So they filed a number of -- The  
12 American Medical Association filed legal  
13 petitions, okay? This was -- The American  
14 Medical Association, various state  
15 authorities, various public health  
16 authorities, reacted very negatively to  
17 Premier, to essentially try and halt the sale  
18 of the product.

19 And this was widely -- The importance of  
20 this was that it was widely promoted, it was  
21 widely communicated to the public. There was  
22 a lot of news coverage. So the idea in a  
23 launch of a new product, you go tell the  
24 media, the local media, here's what your  
25 product is about, hope to get some free  
26 publicity.

27 What happened in this case was exactly  
28 the opposite. There was a lot of publicity  
29 but it was very negative publicity. So what  
30 was communicated to consumers in Arizona and  
31 throughout the country was that the prominent  
32 healthcare authorities were saying this was a

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19656

1 product that there were problems with, that  
2 it shouldn't be marketed.

3 QUESTION: So while the public health  
4 community had been urging the development of  
5 safer cigarettes, when Reynolds developed and  
6 started marketing what could have been a  
7 safer cigarette, the public health community  
8 criticized that cigarette and tried to have  
9 it taken off the shelves; is that right?

10 ANSWER: That's correct.

11 QUESTION: In your research, did you



12 find whether Reynolds went to any government  
13 agencies to try to obtain support for  
14 Premier?

15 ANSWER: Yes.

16 QUESTION: Who did they approach?

17 ANSWER: Well, Reynolds made a major  
18 effort and had visited the Federal Trade  
19 Commission. Again, the Federal Trade  
20 Commission is responsible for regulating  
21 advertisement.

22 Reynolds and its lawyers went to the  
23 Federal Trade Commission and said -- and did  
24 the same thing that it had done with the  
25 public health authorities. Here's the  
26 Premier product, here's the studies we've  
27 done, here's how we're going to advertise it,  
28 we think that -- we think that it's in the  
29 public interest that we market this product  
30 and that we be able to advertise it.

31 QUESTION: Okay. Were you able to find  
32 any evidence that the FTC ever approved the  
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19657

1 selling of Premier cigarettes?

2 ANSWER: No, the FTC never acted. My  
3 research shows the FTC had a major  
4 investigation of Premier and the  
5 advertisements, but the Premier product  
6 failed in test market and was withdrawn. And  
7 so the investigation didn't continue.

8 QUESTION: Were you able to find any  
9 evidence that any public health authority  
10 ever supported the Premier cigarette?

11 ANSWER: I've not found -- I don't know  
12 of any. But overwhelmingly the press  
13 report -- the Premier was reported widely in  
14 the press. And overwhelmingly what was  
15 reported was public health authorities with  
16 very negative opinions about the Premier  
17 product.

18 QUESTION: What happened to Premier in  
19 the marketplace?

20 ANSWER: Premier for a number of  
21 reasons, and one of the most important of  
22 which, all the negative publicity it got from  
23 the public health authorities, failed in the  
24 marketplace. Premier also had problems with  
25 the way it smoked. It was a very different  
26 sort of product. It didn't smoke the way, it  
27 didn't taste the way regular cigarettes did,  
28 so there was a consumer acceptance problem.  
29 There were also problems in the manufacturing  
30 of Premier, which was a very complicated  
31 product to manufacture.

32 QUESTION: Now, there have been  
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19658

1 allegations that Premier failed like many of  
2 the cigarette companies' innovations because  
3 Reynolds failed to market the health benefits  
4 of the product.

5 Do you have an opinion on that?

6 ANSWER: Yes.

7 QUESTION: What is your opinion?

8 ANSWER: Well, what Reynolds did was  
9 exactly try and market the health benefits of  
10 the product to the most important  
11 constituency. They went to the public health  
12 authorities and said, "Look, this is a  
13 product that we think you should, if not  
14 bless, say maybe this is worth a chance. As  
15 you said in low tar and nicotine before, we  
16 think this is even better than lowering tar  
17 and nicotine. We're not saying that it's  
18 safe but we're saying it's worth a chance,  
19 that people might want to try this, it might  
20 be somewhat less risky."

21 That's the most important way. The  
22 history of this industry has shown that what  
23 the public health authorities say is the most  
24 important thing. Low tar and nicotine  
25 products were successful not really because  
26 they were advertised, other than disclosing  
27 they were lower in tar and nicotine; they  
28 achieved their success because the public  
29 health authorities have, from going back to  
30 '57, have said lower tar and nicotine might  
31 be lower risk.

32 There are other important instances  
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19659

1 where prominent healthcare authorities have  
2 talked about specific brands of cigarettes,  
3 like in one case Lark, in another case  
4 Carlton, where prominent healthcare  
5 authorities say this is a unique product, it  
6 might be potentially safer. And what we saw  
7 is very quickly, without any new advertising,  
8 a lot of smokers shifted to that new product.

9 So the most important thing was to get  
10 some positive reception from the public  
11 health authority. Reynolds also went to the  
12 media and told us -- their story to the  
13 media. Here's our story. This is a  
14 potentially -- This is a unique product  
15 that's potentially safer. We'd like you to  
16 tell -- This is the story we'd like you to  
17 communicate to consumers. But overwhelmingly  
18 the publicity was negative.

19 Then Reynolds actually advertised, in  
20 large advertisements, advertised to people  
21 here's this product that's unique, it's not  
22 like any cigarette you've ever heard of  
23 before or smoked, it doesn't burn tobacco, it  
24 has less controversial compounds, and but --  
25 and so it communicated to the public in that  
26 way.

27 But the negative publicity, you know,  
28 killed the product. We see today -- In  
29 recent years you see, if you look in  
30 magazines and things, you see advertisements  
31 for pharmaceutical products, you never used  
32 to see that, for prescription pharmaceutical

19660

1 products.

2 There's been a change in federal  
3 government regulation that's allowed that.  
4 There's very little information in their ads  
5 about -- that say for Allegra or other sorts  
6 of products you see a lot of advertisements  
7 for. What you don't see is stories in the  
8 press from the public health authorities  
9 saying, "This Allegra" or whatever, "this is  
10 terrible for you, you shouldn't use this,"  
11 okay? So you need to have -- you need to  
12 have the endorsement or at least the lack of  
13 criticism of the public health authorities.

14 QUESTION: Now, you said that what the  
15 public health community says is the most  
16 important thing. What do you mean by that?

17 ANSWER: I mean in that we know for  
18 health and safety issues, market research  
19 shows what people primarily are relying on  
20 for health and safety is credible third-party  
21 sources. They don't rely on the companies  
22 that are actually producing the product.

23 They want to know, well, what does the  
24 Surgeon General think about this? Do they  
25 think it's safe? Or what does the media  
26 report? The public health authorities? So  
27 people on health and safety issues  
28 overwhelmingly rely on credible third-party  
29 sources. They don't trust the party  
30 producing the product because they don't view  
31 them properly as an objective source for the  
32 information.

19661

1 QUESTION: Did you find other more  
2 plausible explanations for the failure of  
3 Premier other than the alleged failure to  
4 market it successfully?

5 ANSWER: Yes.

6 QUESTION: And what was that?

7 ANSWER: Well, there were a couple  
8 things. One, the most important, among the  
9 most important was the very negative  
10 publicity and by the credible third-party  
11 sources that this was not a product people  
12 should try.

13 Second, the market research both in the  
14 press and the market research by the company  
15 showed that the product had a lot of problems  
16 in the way it smoked. People said it smoked  
17 like burning tennis shoes and it was very  
18 hard to draw. It wasn't a regular cigarette  
19 product. It had a -- It was definitely an  
20 acquired taste at best. It didn't taste like  
21 a regular cigarette, it didn't draw like a  
22 regular cigarette, it just looked like a  
23 regular cigarette. So it had a lot of  
24 problems with consumer acceptance.

25 QUESTION: Have you brought a board that

26 shows what was reported here locally about  
27 how consumers felt about Premier?  
28 ANSWER: This is, again, an article in  
29 The Times-Picayune, again in 1989 -- 1988 or  
30 1989. This is reporting in the press what  
31 the press was, in talking to consumers, what  
32 they -- what consumers were saying. They  
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19662

1 said, "It smells like a tennis shoe  
2 burning...." "They're terrible. They're  
3 nasty. They're beyond nasty."  
4 You know, that's the sort of -- that's  
5 the sort of publicity that you don't want to  
6 get when you're introducing a new product  
7 that that's what other consumers who have  
8 tried the product are saying about your  
9 product.

10 QUESTION: In your investigation, did  
11 you study whether Reynolds continued to try  
12 to develop a safer cigarette after Premier  
13 failed?

14 ANSWER: Yes.

15 QUESTION: Could you please briefly  
16 describe what you found for the jury?

17 ANSWER: Reynolds, Reynolds, my view of  
18 the -- my review of the documents and public  
19 source material indicates Reynolds thought it  
20 was onto something here, a product that  
21 didn't burn the cigarettes; but for -- didn't  
22 burn the tobacco; but for a lot of reasons  
23 that we talked about, Premier was a failure.

24 So it continued that. And it developed  
25 a new product that's called Eclipse which,  
26 again, is based on the idea of heating the  
27 tobacco, not burning it. A simpler  
28 technology, easier to manufacture. And  
29 arguably better taste characteristics, more  
30 like a regular cigarette than Premier was.  
31 It didn't have a metal tube in it and things  
32 like that. But, again, the idea was the

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19663

1 smoke you would get wouldn't come from  
2 burning the tobacco; it would come from  
3 heating the tobacco.

4 QUESTION: Has Eclipse been criticized  
5 by the public health community so far?

6 ANSWER: Yes, Eclipse has been --  
7 Eclipse has been out in the marketplace now  
8 for several years in different test markets.  
9 And it's received, as with Premier, it's  
10 received criticism in the press by the public  
11 health authorities.

12 QUESTION: Have you brought a board  
13 demonstrating some of the negative press it's  
14 gotten?

15 ANSWER: Yes, I did.

16 QUESTION: And what does what we've  
17 marked as "Exhibit 17" show?

18 (Whereupon the document as described

19 above was marked as "Scheffman Exhibit  
20 Number 17.")  
21 ANSWER: Okay. Now, this is an article  
22 that's in the Chattanooga Free Press,  
23 Chattanooga, Tennessee -- I teach in  
24 Nashville, a ways away -- in '96. Now, why  
25 it's in Chattanooga is that the test -- this  
26 is where the test market for Eclipse was was  
27 in Chattanooga, Tennessee.

28 And this was a prominent article in the  
29 Chattanooga -- in the local press where  
30 Eclipse was in test market. And reported,  
31 reported -- I think there was a forum  
32 sponsored exactly at that time by the

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19664

1 Tennessee Coalition on Smoking or Health.

2 It was convened by this group  
3 specifically because Eclipse was being test  
4 marketed in Tennessee, in Chattanooga, and  
5 convened to get publicity because, in their  
6 view, Eclipse was a bad product, that people  
7 shouldn't smoke it, it shouldn't be marketed.

8 And that was promoted. That was the  
9 advertisements again. That was the publicity  
10 that Reynolds confronted in its test market  
11 in Chattanooga in introducing the Eclipse  
12 product.

13 QUESTION: Have there been any recent  
14 developments regarding Eclipse, Doctor?

15 ANSWER: Yes.

16 QUESTION: What are those?

17 ANSWER: Reynolds has modified the  
18 product somewhat. And again has gone, in the  
19 last year or two, has again relaunched it in  
20 a new -- in a test market again.

21 QUESTION: Okay. Doctor, have you  
22 learned as part of your research whether  
23 there were any responses to the introduction  
24 of the Premier product from Reynolds'  
25 competitors in the United States?

26 ANSWER: Yes.

27 QUESTION: For instance, what was  
28 B & W's response?

29 ANSWER: Well, a number of the other  
30 competitors -- This was a big development.  
31 We know this both from the public press and  
32 from the documents of the various companies.

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19665

1 This was a big development in this industry.  
2 And all the other companies said, "Wait a  
3 minute. This was -- This is a breakthrough  
4 product. What do we have? Do we have  
5 something like this?"

6 So all the other major cigarette  
7 companies in the U.S. looked at: "Can we  
8 produce a product like that?" Brown &  
9 Williamson being one looked at whether it  
10 could produce such a product. And it thought  
11 at that time when it looked at it, in the

12 documents in -- in its documents in the 1980s  
13 that it didn't see a way that it could  
14 produce the same sort of product like that  
15 very quickly.

16 QUESTION: Okay. Did Philip Morris also  
17 have a response to Premier?

18 ANSWER: Philip Morris had a major  
19 research effort to try and produce a somewhat  
20 similar product. And actually eventually  
21 somewhat later, later in the nineties,  
22 actually did produce a product that was  
23 different but had the same basic idea of  
24 heating the tobacco rather than burning it.

25 QUESTION: Okay. Dr. Scheffman, what is  
26 the significance to your opinions of the fact  
27 that Brown & Williamson and Philip Morris all  
28 responded to the introduction of Premier by  
29 putting efforts into their own comparable  
30 products?

31 ANSWER: Well, that's the way  
32 competitive market works. A major company  
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19666

1 comes into the market with a breakthrough  
2 product, what you usually see is that the  
3 competitors say, "Wait a minute. That might  
4 be successful. We better see whether we can  
5 come up with something like that or better."  
6 And that's what you saw happen in this  
7 industry.

8 QUESTION: And is that consistent or  
9 inconsistent with competition?

10 ANSWER: That's exactly the way the  
11 competitive process works.

12 QUESTION: Okay. Now, did Philip Morris  
13 try to develop any other new products?

14 ANSWER: Yes.

15 QUESTION: And what were those?

16 ANSWER: Well, Philip Morris pursued its  
17 own line of approach of trying to develop a  
18 product that heated rather than burned  
19 tobacco. And it came out with a product in  
20 the late nineties called Accord. The Accord  
21 product was, instead of using a match or  
22 flame to heat the product, uses a battery, an  
23 electrical -- The Accord product is a little  
24 electrical device that you stick the  
25 cigarette in. And it heats up the cigarette  
26 and you inhale. So that's a product that is  
27 in test market in various places in the  
28 country. So Philip Morris came out with that  
29 in the late nineties.

30 Earlier in the nineties, Philip Morris  
31 decided to try and produce a product with  
32 very, very little nicotine. And did, using

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19667

1 relatively unique technology, it developed a  
2 process for removing the nicotine from  
3 tobacco, and produced a product and  
4 introduced it in the marketplace called Next.

5 It built a whole plant to manufacture the  
6 product, introduced it into the marketplace,  
7 a product that had virtually no nicotine.  
8 QUESTION: They actually built a new  
9 plant just to build this product?  
10 ANSWER: Yes.  
11 QUESTION: Okay. Could you describe for  
12 the jury the public health community's  
13 reaction to the Next product?  
14 ANSWER: Well, as with these other  
15 breakthrough products, potential breakthrough  
16 products, the public health community's  
17 reaction was very negative.  
18 QUESTION: And have you brought a board  
19 to demonstrate that?  
20 ANSWER: Yes.  
21 QUESTION: And what does this show us?  
22 ANSWER: Okay. This was reported in The  
23 New York Times and was similar to publicity  
24 in many newspapers across the country. This  
25 is quoting someone from the American Medical  
26 Association, "It's not a safer cigarette."  
27 That is public health authority, prominent as  
28 a spokesman for the American Medical  
29 Association saying, "It's not a safer  
30 product."  
31 In other words, the public health  
32 authority are not saying -- They didn't say  
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19668

1 there are no safe products and this isn't  
2 safe, either, but it has no nicotine, so it  
3 might have some benefits compared to other  
4 products that you might consume. They said  
5 nothing like that. What they said is this is  
6 essentially a bad product, it's not safe.  
7 QUESTION: Well, wasn't the public  
8 health community saying at the time that  
9 nicotine had some ill effects and you ought  
10 to try to remove nicotine from cigarettes?  
11 ANSWER: Yes.  
12 This was -- It was accepted by the  
13 Surgeon General, remember, in 1988. This is  
14 a story in '89. In 1988, the Surgeon General  
15 pronounced that cigarettes are addictive.  
16 And there has been before that and since a  
17 lot of publicity about the addictive  
18 qualities of cigarettes.  
19 Philip Morris developed a product with  
20 almost no nicotine, which is the addicting  
21 substance in cigarettes. Nonetheless, the  
22 public health authorities' view of the  
23 product was very negative.  
24 QUESTION: How did Next do in the  
25 marketplace?  
26 ANSWER: Next, for similar reasons to  
27 Premier, failed. It got a lot of negative  
28 publicity. And it also didn't smoke well.  
29 It also didn't achieve any consumer  
30 acceptance. It didn't taste the way a  
31 regular cigarette did.  
32 QUESTION: How is the de-nic history

19669

1 important to your overall analysis in this  
2 case?

3 ANSWER: Well, this is, again, yet  
4 another example. Nowhere else --

5 QUESTION: I'm sorry, Doctor.

6 For the benefit of the jury, could you  
7 explain de-nic?

8 ANSWER: Well, this product, this very  
9 low-nicotine product was called either Next  
10 or de-nic were names that it was marketed  
11 under. It was -- I forget the other brand --  
12 it was something or other brand de-nic, a  
13 version of another brand. That was the  
14 product that it was marketed under, the name  
15 it was marketed under.

16 QUESTION: Okay. Let me rephrase my  
17 question then.

18 How is the de-nic and Next story  
19 important to your overall analysis in this  
20 case?

21 ANSWER: This again, as with Premier, as  
22 with Eclipse, as with Accord, de-nic, Next,  
23 this extremely low-nicotine product, it was  
24 only introduced in the U.S. by one of the  
25 U.S. cigarette companies, nowhere else in the  
26 world. It was a breakthrough product. It  
27 was actually scientifically difficult and  
28 expensive to figure out a way to remove the  
29 nicotine from tobacco.

30 Philip Morris was able to achieve that,  
31 that was clear. It introduced it into the  
32 marketplace, it didn't happen anywhere else

19670

1 in the world. This was a major attempt by  
2 one of the U.S. cigarette companies to  
3 introduce a product into the marketplace that  
4 was potentially safer.

5 QUESTION: Okay. Let's move on to one  
6 more potentially safer cigarette product,  
7 which is Liggett & Myers' Palladium.

8 Are you familiar with that?

9 ANSWER: Yes.

10 QUESTION: Okay. Now, Liggett did never  
11 market a palladium cigarette; did it?

12 ANSWER: No.

13 QUESTION: As part of your analysis,  
14 have you looked into why the palladium  
15 cigarette was not successfully marketed by  
16 Liggett?

17 ANSWER: Yes.

18 QUESTION: What were the reasons that  
19 you found that palladium cigarette never  
20 found its way to the marketplace?

21 ANSWER: Well, again, the palladium  
22 cigarette was a project that Liggett worked  
23 on for a very long time. And the idea was to  
24 add a catalyst to tobacco that might change  
25 the chemical composition of the smoke. That



26 was a very old idea going back to the  
27 fifties.

28 A lot of parties studied that, the  
29 Tobacco Working Group was one. Liggett went  
30 to the Tobacco Working Group and told them  
31 about their research. The Tobacco Working  
32 Group at that time was studying the use of

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19671

1 catalysts. There were a number of problems  
2 with my research on the project, there were a  
3 number of problems, first of which you had to  
4 add palladium. Palladium is a very rare  
5 metal that has -- it's a very dangerous  
6 substance. Palladium is what's used in the  
7 catalytic converter of your car.

8 So palladium was a dangerous substance.  
9 And it was reported by public -- For example,  
10 Dr. Hoffmann, who was one of the prominent  
11 researchers on smoking and health issues,  
12 testified that in addition to palladium  
13 shouldn't be used in cigarettes, it was  
14 highly dangerous. Liggett also had to add  
15 not just palladium but other things to the  
16 product to try and get the chemistry of the  
17 product to work right, which also were  
18 dangerous.

19 So it was -- it had a product that it  
20 thought maybe produced chemically safer smoke  
21 but which it had to add dangerous things to  
22 the cigarette, potentially dangerous things  
23 to the cigarette. That was going to be, of  
24 course, very difficult to market.

25 The documents show that Liggett  
26 perceived that it was going to have  
27 significant difficulty in marketing its  
28 product. For example, there's a Liggett,  
29 there's a series of Liggett documents that  
30 show that -- a Liggett meeting with Liggett  
31 lawyers in The White House, this is in The  
32 White House, this is in the 1970s, to talk to

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19672

1 The White House to see whether The White  
2 House would talk to the Federal Trade  
3 Commission to relent in the regulation of  
4 advertising, to let Liggett market this  
5 product.

6 So there were a lot of problems with the  
7 product. Liggett perceived it was going to  
8 have a problem marketing the product, the  
9 issue of dangerous substances added to the  
10 cigarette were a host of reasons Liggett  
11 chose not to ever market the product.

12 QUESTION: You mentioned Dr. Dietrich  
13 Hoffmann. Now, who is he?

14 ANSWER: Dr. Dietrich Hoffmann was,  
15 again, one of the early researchers that goes  
16 back to the 1950s who had done some of the  
17 early studies in the fifties and studies  
18 going forward on -- that establish what we

19 now know as fact that cigarettes are  
20 dangerous to your health.  
21 QUESTION: Now, Doctor, you've published  
22 in the area of product innovation and you've  
23 studied product innovation as part of your  
24 professional expertise; right?

25 ANSWER: Yes.

26 QUESTION: Okay. Now, Dr. Scheffman,  
27 allegations have been made that had the  
28 cigarette companies in this country devoted  
29 more time, more effort, more money, safer  
30 cigarettes would have been developed and  
31 marketed at some point in the past. As an  
32 expert on innovation, do you believe that all

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19673

1 problems can be solved by simply time and  
2 money?

3 ANSWER: No. I've studied innovation a  
4 lot. And there's lots of -- there are lots  
5 of things that have been studied to death for  
6 a long time and which we don't have the  
7 answer. A popular buzz word, but true  
8 unfortunately, there's no cure for the common  
9 cold, there's no cure for cancer generally.

10 You know, smoking creates uniquely  
11 complicated issues, health problems. The  
12 companies have worked, as have entities all  
13 across the world have been working for fifty  
14 years, to try and develop a potentially safe  
15 product. And this has, thus far, been a  
16 problem that's not been solvable.

17 QUESTION: Doctor, how do economists  
18 evaluate the innovative performance of a  
19 company or an industry?

20 ANSWER: Well, the most important way to  
21 measure innovation is the results. Most  
22 innovative efforts fail. You try and do  
23 something, you can't do it. Like you want to  
24 come up with a cure for the common cold or  
25 certain other sorts of disease or produce a  
26 product of a different kind.

27 We couldn't produce the little cellular  
28 phones and everything that we have today, you  
29 know, it wouldn't have been possible to  
30 produce those in the 1950s and 1960s with the  
31 science available. So most innovations, most  
32 innovative efforts fail. Most are, indeed,

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19674

1 expenditures end up being wasted, wasted in  
2 the sense that it's a good attempt but it  
3 didn't go anywhere.

4 So the most important measure is to  
5 measure what actually happens. And the best  
6 way to do that is when you can benchmark,  
7 which you can in this case. You can look at  
8 the cigarette industry in the U.S. and the  
9 cigarette companies in the U.S. and you can  
10 look at the performance in the U.S. in  
11 innovation compared to all the other

12 countries in the world, large resourceful  
13 companies elsewhere in the world like Japan  
14 Tobacco, other government entities across the  
15 world trying to develop potentially safer  
16 products.

17 The U.S. industry has led the world in  
18 developing potentially safer, lower yield.  
19 And all the breakthrough products that have  
20 been introduced have been introduced in the  
21 U.S.

22 QUESTION: Doctor, there have also been  
23 allegations that the smoking rates in the  
24 United States would be much lower if United  
25 States cigarette companies had been more  
26 competitive as to smoking and health.  
27 Have you had an opportunity to evaluate that  
28 claim?

29 ANSWER: Yes.

30 QUESTION: And do you agree with that  
31 allegation?

32 ANSWER: No, I don't.

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19675

1 QUESTION: Why not?

2 ANSWER: Well, because I've studied --  
3 One of the things economists study in the  
4 cigarette industry is you study the  
5 prevalence of smoking across the world. And  
6 I have done that and actually prepared a  
7 chart. And this is, again, a situation  
8 because there are cigarette industries in  
9 most countries in the world, you can compare  
10 across the world the U.S. with other  
11 countries.

12 Now, what this chart does is this is a  
13 bar chart that shows -- This is -- On this  
14 axis is what's called the prevalence rate,  
15 what percentage of adults are smokers, what  
16 percentage of people 15 years or older are  
17 smokers. This comes from a study sponsored  
18 by the World Health Organization, which is  
19 the definitive study on prevalence across  
20 countries in the world.

21 On the bottom here is not our usual  
22 years that we've had in the other charts.  
23 These are different countries. So we have  
24 Denmark, Greece, Japan, Spain, Sweden, U.S.  
25 So these are smoking rates among what  
26 percentage of people 15 years and older are  
27 smokers in different countries.

28 I've chosen these countries. But WHO  
29 actually reports it for many more countries  
30 in the world. What I've chosen is other  
31 countries that are more comparable to the  
32 U.S., that is, countries with comparable

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19676

1 standards of living to the U.S., western  
2 countries and advanced Asian countries like  
3 Japan.

4 And what you see is that in this rates

5 of prevalence, that is, what percentage of  
6 people smoke, it's relatively low in the U.S.  
7 The U.S. is this green rectangle which in  
8 this year, 1993 about for the U.S., the  
9 prevalence rate in the U.S. was about 25  
10 percent of people 15 or older were smokers.  
11 Whereas, in most other western countries,  
12 smoking rates are higher.

13 Now, that's very important because  
14 different countries are different in other  
15 respects. They have different companies.  
16 The biggest company in Japan is Japan  
17 Tobacco. The biggest company in Spain is a  
18 company called Tabacalara. The biggest -- A  
19 big company in Germany is Reetsma. A big  
20 company in France, Sieta.

21 Different companies in the U.S. --  
22 than in the U.S., different regulatory  
23 environments. Some countries have had  
24 advertising bans, banning cigarette  
25 advertising for a long time, some have had  
26 other different approaches to cigarettes.  
27 Some countries have required companies to  
28 produce -- cap the level of tar in their  
29 cigarettes. Very different across countries.

30 But what you see is that the U.S.  
31 actually sticks out as having relatively low  
32 preference -- prevalence. That is and the

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19677

1 conclusion of that is an argument that the  
2 activities of the U.S. companies has led to  
3 smoking rates being much higher than they  
4 otherwise would be, it just has no basis.  
5 How can it be the U.S. has smoking rates that  
6 are relatively low relative to most of the  
7 rest of the world?

8 QUESTION: Okay. Doctor, let me turn to  
9 another topic. Assume that there have been  
10 allegations that the United States cigarette  
11 companies conspired to reassure smokers in  
12 order to protect the market for cigarettes in  
13 the United States. Have you analyzed how the  
14 tobacco companies communicated with the  
15 public on issues of smoking and health?

16 ANSWER: Yes.

17 QUESTION: And what did you find?

18 ANSWER: What I found is there's no  
19 dispute that the industry, going back to the  
20 fifties and before, communicated to the  
21 public about smoking and health. And have  
22 challenged the Surgeon General's opinion and  
23 challenged the idea of causality. There  
24 isn't any doubt that that's -- that that  
25 happened for many years.

26 There's a couple important things from  
27 an economic and marketing perspective that  
28 you need to take into account in evaluating  
29 that activity and, particularly, its effects.

30 One, the way that companies communicate  
31 to the public was overwhelmingly through the  
32 press, not through advertising. The industry

19678

1 and The Tobacco Institute and other people  
2 speaking for the industry spoke to the press,  
3 and the press reported the story.

4 And my review of the coverage of the  
5 cigarette industry and smoking and health  
6 issues over the last fifty years shows that  
7 overwhelmingly the story told in the press  
8 was negative, that is, that the tobacco  
9 industry had a press release. And the  
10 tobacco industry put forward their view and  
11 there's almost always someone on the other  
12 side, usually earlier in the story, saying  
13 that smoking is bad for you, smoking causes  
14 lung cancer, smoking causes heart disease.

15 And then if the industry position is  
16 reported in the press, it's that someone from  
17 The Tobacco Institute or someone from one of  
18 the companies says, "We don't agree with  
19 causality, we don't agree with that."

20 So what's been communicated to the  
21 public has overwhelmingly not been  
22 communicated directly to the public. It's  
23 been reported to the TV networks and  
24 stations, to radio, to newspapers and  
25 magazines and the reporters told the story.  
26 So that the companies didn't report directly  
27 to consumers. They reported through the  
28 filter of the media. That's the first  
29 important thing.

30 The second important thing that goes  
31 with that is that the tobacco industry hasn't  
32 been the most -- hasn't been the major source

19679

1 of information about smoking and health, it  
2 hasn't been the important source about  
3 smoking and health. Undoubtedly, the  
4 industry put forward its position.

5 But people have been exposed going back  
6 to the 1950s in an overwhelming amount of  
7 press in magazines, in television, in radio,  
8 in public health authorities speaking through  
9 the media and through their doctors and other  
10 personal involvement. The communication to  
11 people has been for -- not by the industry  
12 but it's been basically the message of the  
13 public health authorities.

14 That is going back to the fifties that  
15 it looks like smoking may be a problem. In  
16 1964, the Surgeon General said smoking is a  
17 problem, it looks like it causes lung cancer.  
18 Later, the Surgeon General says smoking  
19 causes other problems, heart disease and  
20 other problems. And that's overwhelmingly  
21 been what's communicated to the public.

22 QUESTION: Have you made similar  
23 investigations when you were at the FTC, or  
24 otherwise in your professional life, as you  
25 did here on that issue?

26 ANSWER: Yes.  
27 Again, for example, in looking at false  
28 and misleading advertising, you have to look  
29 at the whole climate of what people are  
30 exposed to, what information are they exposed  
31 to to determine whether or not you conclude  
32 they were misled by a particular

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19680

1 advertisement.  
2 Again, the important thing here is the  
3 communication really wasn't through  
4 advertisements. The companies haven't  
5 advertised about health through  
6 advertisements, in part, because of the  
7 Federal Trade Commission. What they have  
8 communicated to the press, they've had press  
9 releases, they've spoken in congressional  
10 testimony, et cetera, that have been reported  
11 in the press.

12 QUESTION: Now, you mentioned the  
13 Surgeon General's report. Are you familiar  
14 with the 1988 Surgeon General's report that  
15 received a lot of publicity stating that  
16 nicotine is addictive?

17 ANSWER: Yes.

18 QUESTION: Have you studied what effect,  
19 if any, the information in that report had on  
20 cigarette consumption in the United States?

21 ANSWER: Yes.

22 QUESTION: And what conclusions did you  
23 reach about that effect?

24 ANSWER: Well, the reason why I did this  
25 is there are allegations in this case that  
26 the companies had reason to know that  
27 cigarettes were addictive earlier than 1988  
28 and didn't admit that to the public. And one  
29 issue is would that have made a difference to  
30 the public if someone had said earlier that  
31 cigarettes are addictive?

32 So what we can do as economists, we can

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19681

1 look at the data and we can look at 1988 when  
2 the Surgeon General pronounces to U.S.  
3 citizens and it's widely reported to citizens  
4 through the press that cigarettes are  
5 addictive. Then we can look at rates of  
6 smoking. Was there any effect on rates of  
7 smoking after that? Because people were told  
8 for the first time in the U.S. by the Surgeon  
9 General that cigarettes were addictive. You  
10 can't find any effect in the data, any effect  
11 on smoking rates.

12 QUESTION: Then what does that lead you  
13 to conclude?

14 ANSWER: It leads me to conclude that  
15 that information, that information in itself  
16 didn't have effect on smoking rates. And  
17 from a marketing perspective, in a way it's  
18 not surprising. Because people have forever,

19 according to my research, known that smoking  
20 is very hard to quit.  
21 Most people have themselves or they have  
22 other people in their families or others who  
23 are smokers who know it's very difficult for  
24 them to quit, whether for an individual  
25 person, whether you call that addiction or  
26 it's a habit that you want to give up but you  
27 can't. And probably for most people, it  
28 amounts to be the same thing.

29 QUESTION: Doctor, let's move on to  
30 another topic. Let's talk about regulation  
31 of advertising. You've studied the  
32 regulation of advertising; right?

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19682

1 ANSWER: Yes.

2 QUESTION: From what perspective?

3 ANSWER: From the perspective, again,  
4 I'm not a lawyer and I'm not an expert on --  
5 I'm not going to offer testimony on the law  
6 of advertising. I'm going to talk from a  
7 business economist's perspective and  
8 marketing expert, having spent ten years at  
9 the FTC, having been involved in the  
10 regulation of advertising, and then having  
11 studied as a business expert and economist  
12 the effect of FTC advertising regulation on  
13 companies in advertising.

14 QUESTION: How long has the FTC  
15 regulation been a factor in cigarette  
16 advertising in this country?

17 ANSWER: Going back to the 1940s, the  
18 FTC has been very active in regulating the  
19 advertising of cigarettes.

20 QUESTION: Now, you said earlier that  
21 your principal analysis began in the 1950s.  
22 Is there any significance to the early 1950s  
23 in terms of cigarette advertising?

24 ANSWER: Yes.

25 QUESTION: And what is that?

26 ANSWER: Well, the 1950s is when the  
27 first major health scare which turned out  
28 that we know to be untrue. During the early  
29 1950s, the scientific studies were  
30 published --

31 The healthcare studies, the smoking and  
32 health issues were beginning to be widely

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19683

1 publicized in the early 1950s. And the FTC  
2 was concerned about advertising of cigarettes  
3 at that time. And came to enact a policy, an  
4 FTC policy, with respect to cigarette  
5 advertising specifically.

6 QUESTION: And when were those  
7 advertising guides adopted?

8 ANSWER: In 19 -- What happened in 1954,  
9 the Commission notified the industry and the  
10 public that it was going to promulgate  
11 guidelines for cigarette advertising, that

12 what would be in the FTC's view lawful or  
13 unlawful in the advertising of cigarettes.  
14 It announced those guidelines in '54 and it  
15 actually promulgated them in 1955.

16 QUESTION: Okay. What do you mean by  
17 "promulgate"?

18 ANSWER: In that they were made  
19 official. They were published in the Federal  
20 Register and made official government -- they  
21 were made official as an official government  
22 FTC position on cigarette advertising.

23 QUESTION: Now, does the FTC only have  
24 guidelines for advertising in the cigarette  
25 industry?

26 ANSWER: No, the FTC has guidelines for  
27 lots of industries.

28 QUESTION: As a practical matter, what  
29 is the importance of an FTC guideline?

30 ANSWER: What the FTC guidelines, it  
31 states to the public and to the companies, in  
32 this case the cigarette companies, what the

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19684

1 FTC's position is as to what the -- where the  
2 line is for what companies can advertise or  
3 they can't advertise, saying, "Here's where  
4 the line is. If you stay within these lines,  
5 you're probably not going to have trouble  
6 with us. If you go outside of these lines,  
7 we might sue you."

8 QUESTION: As a general rule, do  
9 industries with FTC advertising guidelines  
10 try to comply with those guidelines?

11 ANSWER: The history of the FTC's action  
12 with respect to advertising is when the FTC  
13 has taken a position on advertising in a  
14 particular industry, there's almost always,  
15 there's very quick compliance by the  
16 companies in that industry to bring their  
17 advertising within compliance of the FTC  
18 guidelines.

19 QUESTION: Now, Doctor, in your  
20 experience, do FTC guidelines have an impact  
21 on the industry just by their issuance?

22 Well, let's take with respect to the  
23 cigarette industry, for instance.

24 ANSWER: Yes. Absolutely.

25 When the FTC issues guidelines, they are  
26 putting the companies on notice, "This is  
27 what we think is lawful advertising, this is  
28 what we think is not." And my experience,  
29 with both the FTC and since, is that major  
30 companies have lawyers that look at "Here's  
31 what the FTC's policy is, here's what our  
32 risk is if we run afoul of these guidelines."

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19685

1 The whole purpose of the guidelines for  
2 the FTC is to stop advertising from occurring  
3 rather than stop it after it's occurring.  
4 The purpose of the guidelines is prospective,



5 that is to say, "Don't advertise like this,  
6 then we won't have to stop it." That's the  
7 whole idea. The FTC would like to have not  
8 advertising -- just advertising not be out  
9 there that's false or misleading at all.  
10 QUESTION: Now, have you brought with  
11 you a board that actually shows the jury what  
12 these guidelines looked like that the FTC has  
13 issued with respect to cigarette advertising?  
14 ANSWER: Yes.  
15 QUESTION: And what is this board?  
16 ANSWER: Well, this is a published  
17 version of the "FTC Rules and Guides," it  
18 says up at the top. You'll see "Cigarette  
19 Advertising Guides." And these are federal  
20 numerical denoters of this. And this is  
21 several paragraphs saying, and these were  
22 released in September of 1955, saying  
23 these -- this is the position of the Federal  
24 Trade Commission on what constitutes -- what  
25 are the bounds that constitute lawful  
26 advertising of cigarettes.  
27 QUESTION: Okay. Now, when the FTC was  
28 getting ready to put these into effect and  
29 publish them, did they ask for public comment  
30 on the proposed guides?

31 ANSWER: Yes.  
32 As always, when the Commission considers  
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19686

1 issuing a policy statement or guidelines, it  
2 asks for comments from interested parties,  
3 including the affected companies and  
4 industry.

5 QUESTION: Did the FTC also request  
6 input from the United States public health  
7 community?

8 ANSWER: Yes.

9 QUESTION: Okay. Can you tell the jury  
10 what the significance is of each of these  
11 guidelines just briefly?

12 ANSWER: Well, the effect of the  
13 guidelines -- Again, this was in 1955. The  
14 health concerns with cigarettes are mounting  
15 at this time because of all the publicity.  
16 And these guidelines came into existence  
17 because of widespread public concern that the  
18 cigarette companies would be advertising in  
19 ways that would -- might take advantage of  
20 the healthcare thing that's -- and, in  
21 particular, communicate something that would  
22 lead people to believe that cigarettes were  
23 safer or safe. So the Commission was  
24 announcing its position. And I won't read  
25 through the legalistic thing.

26 QUESTION: Thank you.

27 ANSWER: But how it came to be viewed in  
28 the industry and by the media that publishes  
29 the advertisements is that health, health  
30 claims in cigarette advertising are not  
31 something that the FTC would like, that is,  
32 you're going to get in trouble with the FTC

19687

1 if you make health claims in advertising.  
2 And this was -- During this period,  
3 there was a lot of concern in the public  
4 press about the advertising that was going on  
5 at that time. So there was some  
6 advertisements by some companies at that time  
7 which were bad ads in the claims they made.

8 And so, for example, the FTC began  
9 promulgating these guidelines, began  
10 developing these in '54. During this time,  
11 parties like the Better Business Bureau and  
12 the AMA went on record saying we should stop  
13 cigarette advertising with respect to health,  
14 petition the government, petition the  
15 companies in the industry, we shouldn't have  
16 any advertising with respect to health of  
17 cigarettes. There was concern in the  
18 Congress and in the media.

19 So the whole climate at this time was  
20 concerned of this is a health issue that  
21 should be dealt with by the U.S. health  
22 authorities; it shouldn't be dealt with  
23 through advertising.

24 QUESTION: Okay. Were you able to  
25 determine from your research whether the FTC  
26 took a position during this period of time  
27 about whether implied health claims would be  
28 used as outlined in the guidelines?

29 ANSWER: Yes.

30 QUESTION: Okay. And did you see any  
31 evidence that the FTC took the position that  
32 health claims would be regarded as a

19688

1 violation of the code?

2 ANSWER: Yes.

3 QUESTION: And what information did you  
4 discover in that respect?

5 ANSWER: Well, if you read the  
6 legalistic language there, you can see that  
7 they spoke more clearly. This is -- This is  
8 testimony before Congress of the Chairman of  
9 the Federal Trade Commission in 1955. The  
10 Chairman was Mr. Secrest, all right? And he  
11 was the Chairman of the Federal Trade  
12 Commission.

13 There was testimony before the Congress.  
14 And it was particularly about false and  
15 misleading advertising in the cigarette  
16 industry, concerned with cigarette industry  
17 advertising. And this is prior -- this is in  
18 1957, after the guidelines, a couple years  
19 after the guidelines have been promulgated in  
20 which there are major hearings in the  
21 Congress.

22 And Mr. Secrest, the Chairman of the  
23 Federal Trade Commission, is saying we  
24 believe that -- "The Commission believes its  
25 industry-wide approach," that is, guidelines

26 that govern everyone in the industry, "have  
27 served to eliminate completely all health  
28 implications from cigarette advertising."  
29 That is, the guidelines have the effect  
30 and the purpose of eliminating completely all  
31 health implications from cigarette  
32 advertising; that is, in any way, not just  
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19689

1 making explicit comments, explicit statements  
2 about health but hinting in various ways like  
3 "Our filter is in some ways healthier than  
4 the other guy's filter," but without saying  
5 anything too specifically about health, that  
6 would be considered to be a claim about  
7 health.

8 And the FTC wanted to stop all those  
9 things, health implications, not just  
10 statements about "Our cigarette is  
11 healthier," which no one could claim, but  
12 a hint in the ads that this was a safer  
13 product.

14 (Whereupon the playback of the above-  
15 referenced videotape is paused at this time.)

16 MR. COPLEY:

17 This is a good place to stop, Your  
18 Honor.

19 THE COURT:

20 We'll recess for lunch at this point  
21 until 1:30 by the wall clock.

22 (Whereupon the jury is excused at this  
23 time.)

24 THE COURT:

25 Let the record reflect the jury has left  
26 the courtroom.

27 Anything for the record by plaintiffs'  
28 counsel?

29 MR. RUSS HERMAN:

30 Yes, Your Honor.

31 This witness has said that the cigarette  
32 companies' issues were, quote, communicated

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19690

1 to the press, not through advertising. We  
2 wish to point out that nine thousand billion  
3 dollars were spent in tobacco company  
4 advertising which went directly into  
5 Louisiana; whereas, the, quote,  
6 communications to the press did not come,  
7 most of them, to Louisiana but were in things  
8 like The New York Times.

9 There are documents which have been  
10 ruled out of evidence before the trial  
11 started relating to advertising, quote, "We  
12 mislead the public with a wink," end quote.  
13 Quote, "We're not fooling anyone by spending  
14 20 million or 30 million dollars over a  
15 ten-year period on research and a hundred  
16 million dollars a year on advertising," end  
17 quote.

18 Premier, Eclipse, Accord and Next failed

19 in the marketplace because they were not  
20 advertised correctly nor extensively. More  
21 money was spent by R. J. Reynolds just  
22 developing the Joe Camel campaign in order to  
23 hook children than was spent on marketing  
24 Premier, Eclipse, Accord and Next.

25 The idea that the tobacco companies on  
26 the one hand can claim preemption, prejudice  
27 and free speech and continue to put before  
28 the juries not just here, but in this  
29 country, all of this evidence from the FTC  
30 guru about marketing and failure in the  
31 marketplace when the advertising issue and  
32 the amount they spend on advertising is

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19691

1 somehow not important only shows half the  
2 picture.

3 And irrespective of learned counsel's  
4 opposition to these remarks, we will preserve  
5 this issue to the extent that we can.

6 THE COURT:

7 Well, Mr. Herman, I think you've done  
8 that adequately. And I just wonder have you  
9 a motion to make?

10 MR. RUSS HERMAN:

11 Not at this point, Your Honor.

12 THE COURT:

13 We will recess for lunch until 1:30.

14 MR. RUSS HERMAN:

15 Thank you, Your Honor.

16 THE COURT:

17 Anything by defense counsel?

18 And please don't respond to Mr. Herman  
19 unless you just want the record to be larger  
20 than it might otherwise be. There's no  
21 motion, there's nothing for me to rule on.

22 Anything other than that for the record?

23 MR. PETERSON:

24 We have nothing further, Your Honor.

25 THE COURT:

26 We will recess until 1:30.

27 (Whereupon the proceedings were  
28 adjourned at 12:00 o'clock noon.)

29 \* \* \* \* \*

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19692

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16 in the outcome of this matter.  
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